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(Term - 2)

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BUSINESS STUDIES (CODE -054)
CLASS–XII (2021-22)
TERM WISE CURRICULUM(TERM 1)

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CHAPTER – STAFFING

STAFFING:

“Staffing is the process of management which is concerned with obtaining, utilising and maintaining a satisfactory and satisfied workforce.”

Staffing means appointing competent persons according to the requirement of posts, in the organization and keeping these posts filled with regular efforts.

It includes identification of requirement of work force, recruitment, selection, training and development, promotion, appraisal of employees to fill the posts in the organization and keeping them filled.

IMPORTANCE OF STAFFING-

1. Obtaining Competent Personnel: Proper staffing helps in discovering and obtaining competent personnel for various jobs.
2. High Performance: Proper staffing ensures higher performance by putting right person on the right job.
3. Continuous Growth: Proper staffing ensures continuous survival and growth of the enterprise through succession planning for managers.
4. Optimum Utilization of Human Resources: By avoiding over-staffing and under staffing.
5. Improves Job Satisfaction: It improves job satisfaction and morale of employee through objective assessment and fair reward of their contribution.

STAFFING PROCESS-

1. Estimating Manpower Requirement: It includes finding out the number and types of employees needed by the organization. It includes :
 - A. Workload Analysis : It would enable an assessment of number and types of human resources necessary for the performance of various jobs.
 - B. Workforce Analysis : It would reveal the number and type of human resources available. It would reveal whether the organisation is under-staffed, over-staffed or optimally staffed.
2. Recruitment: It is process of searching and motivating candidates to apply for a job.
3. Selection: Selection is the process of choosing the most appropriate candidate out of various applicants for vacant jobs through various exams, tests & interviews.
4. Placement and Orientation: Placement refers to placing the selected and appointed persons on the concerned job. Orientation means introducing the newly selected employees to other existing employees and familiarizing them with the rules and policies of the organisation.
5. Training and Development: Systematic training helps in increasing the skills and knowledge of employees in doing their jobs through various methods.

Development involves growth of an employee in all respects. It is the process by which the employees acquire skills and competence to do their present jobs and increase their capabilities for higher jobs in future.
6. Performance Appraisal: It is concerned with rating or evaluating the performance of employees. Transfers and promotions of the staff are based on performance appraisal.
7. Promotion and career planning: Managers need to design activities to serve employees' long-term interests by encouraging employees to grow and realise their full potential and providing them by career related and promotional avenues .

8. Compensation : Compensation refers to all forms of pay or rewards going to employees. It may be direct financial payment like wages, salaries etc. or indirect payments like medical facility, conveyance facility etc.

RECRUITMENT

Recruitment is the process of searching different sources of prospective employees and stimulating them to apply for the vacant posts in the organization.

SOURCES OF RECRUITMENT-

1. Internal sources:-

- i. Promotion - It is a process by which an employee working on a lower job position is shifted to higher job position which carries higher authority, responsibility, status and pay. It is vertical shifting of employees.
- ii. Transfer - It means shifting of an employee from one department to other department, from one branch to other branch or from one shift to other shift on the same level of responsibility, authority and status of an employee. It is horizontal shifting of employees.

2. External Sources –

- i. Direct recruitment / At factory gate: A notice is placed on a notice board/gate of the enterprise specifying the details of the job available.
- ii. Casual callers:- Unsolicited applications(prospective candidate send their CV even though post is not advertised), database can prove to be an excellent source of recruitment.
- iii. Campus Placement:- Many large organizations contact educational institutes like universities, management institutes, professional institutes etc. to pick up the young and talented persons with latest knowledge.
- iv. Advertising : Advertisement in newspaper ,magazines or TV regarding vacant post.
- v. Employment exchanges:- Government based agency for unskilled and skilled operative jobs.
- vi. Placement agencies and management consultant :- These agencies are setup by private individuals. Through these agencies, usually the candidates for higher and middle level jobs are selected.
- vii. Labour contractor : They are link between labourers & managers. As and when managers put up demand for labour, these contractors make available their supply in no time.
- viii. Employee recommendation : Many firms encourage their employees to recommend the name of their relatives, friends for the employment.

ix. Web Publishing. There are certain websites specifically designed to provide information, regarding job seekers and companies which have vacant job positions.

SELECTION-

Selection is the process of identifying and choosing the most competent and suitable persons out of several applicants for the vacant jobs on the basis of predetermined qualifications & tests.

SELECTION PROCESS:-

1. Preliminary Screening: After applications have been received, they are properly checked as regarding qualification etc. by screening committee. A list of candidates to be called for employment tests is made and unsuitable candidates are rejected altogether.

2. Selection Tests: These tests include :

Intelligence test: It measures the level of intelligence quotient of an individual. It is an indicator of a person's learning ability or the ability to make decisions and judgements.

Aptitude test: It is a measure of individual's potential for learning new skills. It indicates the person's capacity to develop.

Personality test: Personality tests provide clues to a person's emotions, reactions, maturity, value system, etc. These tests judge the overall personality.

Trade test: These tests measure the existing skills (professional knowledge and proficiency) of the individual.

Interest test: Interest tests are used to know the pattern of interest or involvement of a person

2. Employment Interviews: The main purpose of interview is to find out suitability of the candidates. to seek more information about the candidate. to give the candidate an accurate picture of job with details of terms and conditions.

3. Reference Checks: Prior to final selection, the prospective employer makes an investigation of the references supplied by the applicant. He undertakes a thorough search into candidate's family background, past employment, education, police records etc.

4. Selection Decisions : A list of candidates who clear the employment tests, interviews and reference checks is prepared and then the selected candidates are listed in order of merit.

5. Medical/Physical Examination: A qualified medical expert appointed by organization should certify whether the candidate is physically fit to the requirements of a specific job. A proper physical exam will ensure higher standard of health & physical fitness of employees thereby reducing absenteeism.

6. Job Offer: After a candidate has cleared all hurdles in the selection procedure, he is formally appointed by issuing him an Appointment Letter. The broad terms and conditions, pay scale are integral part of Appointment Letter.

7. Contract of Employment: After getting the job offer, the candidate has to give his acceptance.

After acceptance, both employer and employee will sign a contract of employment which contains terms & conditions, pay scale, leave rules, hours of work, mode of termination of employment etc.

TRAINING AND DEVELOPMENT-

Training is the process of increasing the skill, abilities and aptitude of an employee to perform a specific job efficiently in an expected manner.

Development

It refers to the learning opportunities designed for the overall growth of an employee. It refers to the process by which the employees acquire skill and competence to do their present jobs and increase their capabilities for handling jobs in future. It focuses on the growth of an individual in all respects.

Need/Importance/Advantages of Training

(A) Benefits of the Organization

- (1) Training is a systematic learning that is always better than hit and trial method, which leads to wastage of efforts and money.
- (2) It enhances employees' productivity both in terms of quantity and quality leading to quality output with minimum inputs.
- (3) Training equips the future managers who can take over in case of emergency.
- (4) Training increases employees' moral and reduces absenteeism and employees turn over.
- (5) It helps in obtaining effective response to dynamic technological and economical environment.

(B) Benefits to Employees

- (1) Improved skills and knowledge due to training lead to better career of the employees.
- (2) Increases performance of employees help them to earn more.
- (3) Training makes the employees more efficient to handle the machines. Thus, there will be less chances of accidents.
- (4) Training increases the satisfaction & moral of employees.

METHODS OF TRAINING

- (1) **On the job training:-** On the job method refers to the methods that are applied to the actual work place, while the employees are actually working. It means learning while doing. Its methods are apprenticeship training, internship training, job rotation training etc.
- (2) **Off the job training:-** Under this method, training is imparted to the trainees at a place other than the place of actual work. It is learning before doing. Its methods are classroom lectures, vestibule training etc.

Apprenticeship Training

Under this training, the trainee is required to work with an expert for a specific period of time say 2 to 5 years. On acquiring complete proficiency, the employee is posted to the actual job. For example giving training to electricians, plumbers, ironworks, carpenter etc.

Internship Training

Under this method, educational or technical institutions and business organizations jointly impart training to their members. For example: the course of C.A, Nursing etc.

Vestibule Training

Under this method, with a view to impart training to new employees, a separate training centre is setup away from the actual workplace. Machines, tools and other equipments are so arranged in this centre as to give a look of actual workshop.

Difference between Training and Development:-

Basis	Training	Development
1. Meaning	It is a process of increasing knowledge & skills relating to a particular job.	It is concerned with making employees skilful in all respects.
2. Scope/ Concept	Its scope is narrow as it is concerned with teaching technical skills only.	It is wider term and includes training also. It is concerned on teaching technical skills and conceptual skills.

3. Suitability	It is suitable for technical staff.	It is more suitable for managerial staff.
4. Work or person centred	It is work centred/ job oriented.	It is person centred/career oriented.
5. Duration	Its duration is comparatively shorter.	Its duration is longer than training.
6. Focus	It focuses on the present requirement of the organization.	It focuses on the present as well as the future requirement of the organization.
7. Methods	It's methods are vestibule training, internship training etc.	It's methods are seminars, lectures, conferences etc.

Short Question Answers:

Q. 1 A "management expert" was invited by a company. He gave a lecture in the meeting of employees. Main points of the lecture were, "Employees should make all out efforts to increase their market value. To achieve this objective they should increase their capacity and efficiency. They should also make such endeavour as to get job satisfaction. Not only that, it is equally essential that they should concentrate on minimizing the accidents". Management expert is hinting at an element of staffing function of the management which is beneficial both for the enterprise and the employees. Identify it.

Ans. Training.

Q.2 "Pushpanjali Pvt. Ltd." is a renowned company manufacturing different kinds of gifts. Mr. Subhash Kathuria, H.R. Manager is keen to select such persons who are well equipped with the latest knowledge. He also desires that the area of selection should be extensive. In your opinion which source of recruitment should be used by H.R. Manager?

Ans. External Source.

Q.3 It is the custom of a company to avoid to say 'No' to any person who approaches it for a job. Rather it gets his application and tells him that as and when company requires his services, he will be called. In this way, company acquires a database. Its advantage is that at the time of need a suitable applicant out of the

database can be called for interview. Thus the company is saved from expenses on advertisement. Identify the source of recruitment referred to in the above paragraph.

Ans. Casual Callers.

Q. 4 Managing Director of "Rathi India Limited" convened a meeting of the employees working at all managerial levels. Two main issues were discussed in the meeting. First, how the employees should perform all those activities more efficiently which are being carried out currently. Second, how to enable the employees to take upon itself big responsibilities in future. Through the medium of the meeting, the company was seeking the possibilities of its extension. When the managing director felt satisfied that the employees were taking interest in both the issues, then he convened a meeting of board of directors to give final shape to the decision regarding extension of the company.

Identify and explain those concepts of managements which relate to both the issues discussed in the meeting.

Ans.* Concept relating to the first issue:

Training: It refers to a process designed to maintain and improve current job performance.

- Concept relating to the second issue:

Development: It refers to a process designed to develop skills necessary for future activities.

Q.5 Why recruitment is regarded as a Positive Process and selection is a negative process.

Ans. Recruitment is Positive Process because it is concerned with attracting qualified and competent individuals to apply for a job while selection is choosing the best among them and rejecting the unsuitable candidates.

Q. 6 Alpha Enterprises is a company manufacturing water geysers. The company has a functional structure with four main functions-Production, Marketing, Finance and Human Resource. As the demand for the product grew, the company decided to hire more employees.

Identify the concept which will help the Human Resource Manager in deciding the actual number of persons required in each department.

Ans: Workload analysis is the concept which will help the Human Resource Manager in deciding the actual number of persons required in each department

Q.7 Anuroop runs a law firm in Hyderabad. His firm offers valuable financial and legal consultancy services to the clients. Whenever the firm hires any new employees, on the first day of their joining, they are welcomed to the organisation and are given details about hours of work, holiday requests, sickness procedure, dress code, lunch arrangements, introduced to the daily operations and key people in the workplace, etc. They are also familiarised with the organisation's policies and procedures, including complaints and dispute resolution, sexual harassment, emergency exits and evacuation procedure.

Name the type of training which is being referred to in the above lines.

Ans. Induction training is being referred to in the above lines.

Q. 8 Explain briefly 'Casual Callers' and 'Labour Contractors' as external sources of recruitment.

Ans:

1. **Casual callers:** Casual callers is considered to be relatively cheaper source of recruitment in comparison to the other sources. This is because the organizations has to primarily maintain a database in their offices of the unsolicited applicants who sent their resume in anticipation of job prospects. As an when a vacancy arises in the organization such job-seekers may be screened.
2. **Labour contractors:** Labour contractors proves to be a very useful resource for appointing the required number of unskilled workers at short notice. However, if the labour contractors who themselves are the employees of the organization decide to leave it for any reason then all the workers recommended by him are also likely to leave the work along with him.

Q.9 Race Tech Ltd. is one of the top IT companies in India. The company does mass recruitment each year from different colleges offering fresher level job to the final year students. This helps in recruiting the brightest and the best available talent in the educational institutions.

In context of the above case:

1. Identify the source of external recruitment adopted by the company.
2. Explain briefly any three advantages of using the external sources of recruitment.

Answer:

1. Campus Recruitment is the source of external recruitment adopted by the company.
2. The advantages of using the external sources of recruitment are stated below:
 - o **Qualified Personnel:** Through the external sources of recruitment, the management is able to attract qualified and trained people to apply for the vacant job positions in the organisation.
 - o **Wider Choice:** As the vacancies are advertised widely a large number of applicants from outside the organisation are likely to apply. This gives the organisation a wider choice while selecting the people for employment.
 - o **Fresh Talent:** The organisations cannot fulfil all the vacancies from within the organisation. Therefore by using the sources of external recruitment they get a wider choice and it brings new blood into the organisation.

Q. 10 Srija runs an NGO under the name 'Sarvak' in Delhi. The organisation is engaged in offering waste paper recycling services to all kinds of institutions in the Delhi NCR region. It also manufactures custom made paper stationery out of recycled paper on order for the interested institutions at a very competitive price. The website of 'Sarvak' provides a link to a Careers site wherein the people desirous of joining the NGO can use simple Job Search to find the right opportunity for themselves. The NGO also keeps a

database of unsolicited applicants in its office so that job seekers may be notified of future opportunities when they arise.

In context of the above case: Identify the two sources of external recruitment being used by the NGO 'Sarthak' by quoting lines from the paragraph.

Ans. The two sources of external recruitment being used by the NGO 'Sarthak' are as follows:

- o Web Publishing: "The website of 'Sarthak' provides a link to a Careers site wherein the people desirous of joining the NGO can use simple Job Search to find the right opportunity for themselves"
- o Casual Callers: "The NGO also keeps a database of unsolicited applicants in its office so that job seekers may be notified of future opportunities when they arise."

Long Question-Answers:

Q.1. Mr. BheemRajanwala is working as a personnel manager in a company of Delhi. Although he is not well educated, he is an experienced person. Before this he has worked on this post in two large companies. His intention is always in promoting an efficient employee to a higher post and in demoting inefficient one to a lower vacant post.

(i) State on what source of recruitment is Mr Rajanwala concentrating?

(ii) What are the benefits of which company is depriving by using this source?

Ans. (i) Mr Rajanwala is concentrating on internal source of recruitment.

(ii) By using this method the company is depriving of the following benefits: External recruitment source has the following merits:

- (i) Qualified Personnel: The external source of recruitment gives an opportunity to the qualified people from outside the organisation to enter it. This benefits both the organisation and the applicants from outside.
- (ii) Wider Choice: By using the external source of recruitment, the number of applicants increase manifold which in turn increase the area of choice. The managers can appoint the most talented persons after examining the capabilities and talents of all the applicants.
- (iii) Fresh Talent: The external source of recruitment helps the people with new and modern ideas to enter an organisation which certainly helps the organisation.

Q. 2 Business of "Shardha Auto Pvt. Ltd." is confined only to one state. Now it intends the same to too other states. Mr.Jatin Jain the managing director of the company, is busy in making a plan to this effect. First of all, he contacted Mrs Rukmani Devi Rana, the H.R. manager of the company. Both were of the opinion that they would require 75 more employees to extend the business to too new states. On looking at the record of the existing employees, that 8 employees were going to retire very shortly. Besides, two

employees were proceeding on long term study level abroad for two years. Thus company would now require 85 employees in all. Mrs.Rana recommended to Mr Jatin that out of the total vacant post, 15 be reserved for women. Mr Jain gladly accepted the proposal. Now, HR manager was to decide as to that arrangement be made for the employment of needed persons. She hit upon a plan. According to this plan some employees would be recruited with the help of existing employees, for some other internet would be approached and for the remaining potential employees placement agencies operating in the market would be contacted.

(a) Describe what function of management has been referred to in the above paragraph?

(b) What sources of recruitment are being used by H.R. Manager? Explain briefly.

Ans. (a) Staffing

(b) Sources of recruitment used by the HR manager

(i) Recommendation: With a view to establishing good employer-employee relations sometimes manager recruit people-on the recommendation of their existing employees. In this way, the present employees feel encouraged and there is a complete control over new employees. This source is mostly used for appointing lower-level employees.

(ii) Internet/Websites: Currently internet is an important medium for recruitment. Information regarding vacant posts and essential qualifications required can be obtained by the applicant through them.

Applicants having the requisite qualifications can contact those companies which need their services. Some of the very popular websites are: www.naukri.com, www.obstreet.com and www.clickjobs.com etc.

(iii) Private Placement Agencies: These agencies are set up by private individuals. Persons in search of job can get their names registered with them. Such registrations are meant usually for high or medium level jobs. On the request of an organisation, these agencies do the whole work of recruitment on their behalf. They get their fee for the service rendered to the organisation.

Q. 3 Prateek has started an advertising agency in Gurgaon. One of the page on his company's website contains the following information, "Welcome to all the visitors of this page who are looking for an opportunity to make a career in the field of advertising. The openings are available in the company at various levels, so don't miss the chance." This page includes a link to provide further details about the vacancies available in terms of the desired qualifications, experience, personality characteristics and so on. Through a continuous assessment of the number and types of human resources necessary for the performance of various jobs and accomplishment of organisational objectives and in relation to the number and type available, he gets the information on this page updated.

In context of the above case:

Identify and explain the steps in the staffing process being carried out by Prateek by quoting lines from the paragraph.

Ans. The two steps in the staffing process being carried out by Prateek are as follows:

- o Estimating the Manpower Requirements: It is the first step in the staffing process and is carried out with the help of workload analysis (assessment of the number and types of human resources necessary for the performance of various jobs and accomplishment of organisational objectives) and work force analysis (assessment of the number and type available).
“Through a continuous assessment of the number and types of human resources necessary for the performance of various jobs and accomplishment of organisational objectives and in relation to the number and type available.”
- o Recruitment: Recruitment may be defined as the process of searching for prospective employees and stimulating them to apply for jobs in the organisation.
“One of the pages on his company’s website contains the following information, “Welcome to all the visitors of this page who are looking for an opportunity to make a career in the field of advertising. The openings are available in the company at various levels, so don’t miss the chance.” This page includes a link to provide further details about the vacancies available.....
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Q.4 Anushka is doing a course in fashion designing from an institute of repute. As a part of the course, she has been asked to take on-the-job training in an export house for a fortnight in order to gain an insight about various practical aspects related to designing. Anushka, through the references from her senior, joins an export house owned by an upcoming designer, Nandita.

In context of the above case:

1. Name and explain the type of training which Anushka has been asked to undertake.
2. Explain briefly any one method for providing off-the-job training.

Answer:

1. Internship Training is the type of training which Anushka has been asked to undertake. It is a joint programme of training in which educational institutions and business firms co-operate. The learners carry on with their regular studies for the prescribed period. They also work in some factory or office to acquire practical knowledge and skills related to their specific field of expertise.
2. Vestibule training is a popular method for providing off-the-job training. The term ‘vestibule’ means duplicate or replica. Under this method, the trainees learn their jobs on the equipment they will be using at their actual work place. The training is conducted away from the actual work floor at a place where actual work environments are created in a class room and employees use the same materials, files and equipment. This is usually done when employees are required to handle sophisticated machinery and equipment. .

Q.5 Sunder Lai runs a security service providers agency. Considering that psychological testing is a critical step for judging the potential of the prospective candidates for a career in law enforcement, he uses various types of psychological tests as part of the selection processes. This is done to ensure that potential new officers are emotionally and psychologically suited to carry out the requirements of the job.

In context of the above case:

1. Briefly outline any one more type of test that Sunder Lai may use to assess the potential of the prospective candidates.
2. Briefly outline the steps involved in the selection process after conducting the assessment tests.

Answer:

1. Interest Tests: Interest tests are used to know the pattern of interests or involvement of a person.
2. The further important steps in the process of selection, after conducting assessment tests are as follows:
 - o Employment Interview: It is a face-to-face interaction between the interviewers and prospective candidate. It involves a formal, in-depth conversation that is conducted to evaluate the applicant's suitability for the job.
 - o Reference and Background Checks: At the time of filling up of the job application form, the prospective candidates are required to provide names, addresses, and telephone numbers of references for the purpose of verifying information and gaining additional information about him/her.
 - o Selection Decision: The final decision about the selection is made from among the candidates who pass the tests and interview.
 - o Medical Examination: After the selection decision and before the job offer is made, the candidate is required to undergo a medical fitness test.
 - o Job Offer: The next step in the selection process is job offer, given to those applicants who have passed all the previous tests.
 - o Contract of Employment: After candidate accepts the job offer, a contract of employment is issued. Basic information that should be included in a written contract of employment will vary according to the level of the job, but it will include information like job title, duties, responsibilities, date of joining, pay and allowances, etc.

Q.6 "If you wish to plan for a lifetime, develop people." In the light of the above statement explain why training of employees is necessary for an organisation?

Ans. Training is necessary to an organisation due to following reasons :—

1. Reduced learning Time : A trained employee takes less time in learning the job as compared to untrained employee. Training is systematic learning always better than hit and trial methods which lead to wastage of efforts and money.
2. Better performance : The performance of trained employees is always better than the performance of untrained employees as in the training programmes their qualities and capabilities are improved.
3. Attitude formation : The training and development aim at moulding the employees so that they develop positive attitude for the organisation.
4. Improvement in quality and quantity of output : Training helps to improve the quantity and quality of output.
5. Better career : Improved skills and knowledge due to training leads to better career to the individual.
6. More learning : Increased performance by the individual help him to earn more.
7. Increase morale of Employees : Training increase the satisfaction and morale of employees

Q.7 What are the Methods of internal recruitment? Explain merits and limitations of internal recruitment.

Ans:- Following are important sources of internal recruitment:

- I. Transfers: It involves the shifting of an employee from one job to another, from one department to another or from one shift to another shift.
- II. Promotions: It refers to shifting an employee to a higher position carrying higher responsibilities, prestige, facilities and pay.

Advantages of Internal Sources of Recruitment:

- (a) Employees are motivated to improve their performance.
- (b) Internal recruitment also simplifies the process of selection & placement.
- (c) No wastage of time on the employee training and development.
- (d) Filling of jobs internally is cheaper.

Limitation of Internal Sources :

- (a) The scope for induction of fresh talent is reduced.
- (b) The employee may become lethargic.
- (c) The spirit of competition among the employees may be hampered.
- (d) Frequent transfers of employees may often reduce the productivity of the organization.

CHAPTER –

DIRECTING

Meaning Of Directing:-

Directing means giving instructions, guiding, and counseling, motivating and leading the staff in an organization in doing work to achieve Organizational goals. It refers to instructing, guiding, communicating and inspiring people to achieve common objectives.

Characteristics of Directing :-

1. **Pervasive Function-** Directing is required at all levels of organization. Every manager provides guidance and inspiration to his subordinates.
2. **Continuous Activity-** Direction is a continuous activity as it continues throughout the life of organization.
3. **Human Factor-** Directing function is related to subordinates and therefore it is related to human factor. Since human factor is complex and behaviour unpredictable, direction function becomes important.
4. **Creative Activity-** Direction function helps in converting plans into performance. Without this function, people become inactive and physical resources are meaningless.
5. **Executive Function-** Direction function is carried out by all managers and executives at all levels throughout the working of an enterprise, a subordinate receives instructions from his superior only.
- 6- **Delegate Function-** Direction is supposed to be a function dealing with human beings. Human behaviour is unpredictable by nature and conditioning the people's behaviour towards the goals of the enterprise is what the executive does in this function.

IMPORTANCE OF DIRECTING:-

1. **Initiates Action:** It helps to initiate action by the people in the organization towards attainment of desired objectives.
2. **Integrates Employee's Efforts:** All the activities of the organization are interrelated and it is necessary to coordinate all the activities. It integrates the activities of subordinates by supervision, guidance and counselling.
3. **Means of motivation** It motivates the subordinates to work efficiently and to contribute their maximum efforts towards the achievement of organizational goals.
4. **Facilitates change:** Employees often resist changes due to fear of adverse effects on their

employment and promotion. Directing facilitates adjustment in the organization to cope with changes in the environment.

Elements of directing:-

- (i) **Supervision**-implies overseeing the work of subordinates by their superiors .It is the act of watching & directing work & workers.
- (ii) **Motivation**-means inspiring stimulating or encouraging the sub-ordinates with the work. Positive ,negative, monetary, non-monetary incentives may be used for this purpose.
- (iii) **Leadership**-may be defined as a process by which manager guides and influences the work of subordinates in desired direction.
- (iv) **Communications**-is the process of passing information ,experience ,opinion etc from one person to another .It is a bridge of understanding.

1. **Supervision** ,as an element of directing:

process of guiding the efforts of employees and other resources to accomplish desired objectives. Overseeing people at work **Involves instructing, observing, monitoring and guiding employees.**

Carried out at all levels but more important at the lower levels therefore the term 'Supervisor' used at the operatives level of management

Motivation

Motivation :- It refers to that process which encourages people to work for the attainment of a desired objective.

Maslow's Need Hierarchy Theory

Maslow's need hierarchy is considered to be fundamental to the understanding of motivation and plays an important role in motivation.

- 1- **Basic need**-Most basic in the hierarchy and corresponds to primary needs. Hunger, thirst, shelter ,sleep
- 2- **Social needs** - Security and protection from physical and emotional harm, stability of Income etc.
- 3- **Affiliation/ Belonging needs**- Refers to affection, sense of belongingness ,acceptance and friendship.
- 4- **Esteem Needs**- Include factors such as self-respect ,autonomy status, recognition and attention

- 5- Self Actualisation Needs- The drive to become what one is capable of becoming. These needs include growth, self- fulfillment and achievement of goals

INCENTIVES

:Incentive means all measures which are used to motivate people to improve performance

Types of incentives

- (i) Financial Incentives (ii) Non-Financial Incentives

Example of financial incentives:-

1. Pay and allowance
2. Productivity linked incentive schemes
3. Bonus
4. Profit sharing
5. Co-partnership/ Stock options
6. Retirement benefits
7. Perquisites

Non monetary incentives are as follows:-

1. Status
2. Organizational climate
3. Career advancement opportunities
4. Job enrichment
5. Employee recognition programmes
6. Job security
7. Employee participation
8. Employee empowerment

I. Leadership

It refers to influence others in a manner to do what the leader wants them to do. . Leadership indicates the ability of an individual to maintain good interpersonal relations with followers and motivate them to contribute for achieving organizational objectives. It is a process of interaction between the leader and his followers.

Styles of Leadership

Different types of leadership style are:

1. Autocratic leadership
2. Participative leadership/Democratic
3. Free rein leadership/Laissez Faire

I. Autocratic or Authoritarian Leadership:-

Under this style ,autocratic leader gives order and expects his subordinates to obey those order.He keeps all the decisions without consulting the subordinates. No suggestions or initiative from subordinates is entertained.

It is best applied to situations where there is little time for group decision making or where the leader is the most knowledgeable member of the group.

2. Democratic or Participative Leadership

A democratic leader gives order only after consulting the group and works out the policies with the acceptance of the group.

This improves the attitude of the employees towards their jobs and the organization thereby increasing their morale. Using this style is of mutual benefit - it allows them (subordinates) to become part of the team and helps leaders (seniors) to make better decisions

3. Laissez Faire or Free Rein Leader

It refers to a leadership style in which the leader gives his subordinates complete freedom to make decisions . Such a leader avoids use of power. He depends largely upon the group to establish its own goals and work out its own problems. Group members work themselves as per their own choice and competence.:

Communication

It is a process of transfer of information from the sender to the receiver with the information being understood by the receiver.. Communication is important for the directing function because all other elements of directing become possible only when there is adequate communication.

Elements of Communication Process

1. Sender: Who conveys his thoughts or ideas.

2. Message: Ideas, feelings, suggestions, order etc.
3. Encoding: Converting the message into communication symbols such as words/ pictures etc.
4. Media :Path/Channel through which encoded messageTransmitted to receiver e.g., face to face ,phone call, internet etc.
5. Decoding: Converting encoded symbols of the sender.
6. Receiver: Who receives communication of the sender.
7. Feedback: All those actions of receiver Indicating that he has received and understood the message of the sender.
8. Noise: Some obstruction or hindrance .

Importance of Communication

1. **Facilitates Coordination:** between interrelated departments and sections thus creating a unity of purpose and action.
2. **Provides data necessary for decision makings:** When information is effectively and efficiently communicated to management.
3. **Promotes cooperation and Industrial Peace:** The two-way communication promotes cooperation and mutual understanding between the management and workers and brings peace in the organization.
4. **Establishes effective leadership:** Effective communication helps to influence subordinates. While influencing ,a leader should possess good communication skills.

Types of communication:-

Formal communication- Official communication following the chain of command. It Is concerned with official matters.

Advantages of formal communication:-

- 1-systematic
- 2-responsibility can be easily fixed
- 3-source of information can be easily located
- 4-helps in the coordination.

Disadvantages:-

- 1-very impersonal

2-slow process

3-it is rigid process

Informal Communication- Takes place without following the formal lines of communication is said to be informal communication.

Advantages of informal communication:-

1-information spreads very fastly

2-social satisfaction

3-can get immediate responses of subordinates

4-it provides emotional relief to employees

Disadvantages:-

1- Spreads rumours

2- Not easy to fix the responsibility

3- Unsystematic way

4- Confidential information can gets disclosed.

Question Answers:

1	In an organisation, employees always feel motivated as leader always consults his subordinates on proposed actions and decisions. They take a lot of initiative and do not fear to express their problems before the manager. Identify and explain the leadership style does the manager follow in the referred situation? Also discuss any other kind of leadership styles .followed by different managers. Answer=Democratic leadership style.. Other styles are :- 1- Autocratic style 2- Free rein leadership	
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2	Mr. Rohan , Mr. Mohan and Mr. Sohan are the production manager, sales manager and finance manager of LAXMI Pharmaceuticals & Chemicals Ltd. All three are efficient in completion of their task. (a) Mr. Rohan does not discuss with his subordinates and does not give any freedom to them in framing the policies. (b) Mr. Sohan depends up on his subordinates to achieve the goals. He does not interfere in his activities. (c) Mr. Mohan gives order only after consulting subordinates on proposed actions and decisions. Identify and explain the behavioural pattern of the three managers. Answer=(a) Autocratic leadership. (b) Free-rein leadership. (c) Democratic leadership.	
3	Sonu is the Managing Director of x Ltd. The company had established a good name for itself and had been doing well. It was known for timely completion of orders. The Production Manager, Ms.Bimla was efficiently handling the processing of orders and had a team of fourteen motivated employees working under her. Everything was going on well. Unfortunately she met with an accident. Sonu knew that in the absence of Ms.Bimla the company may not be able to meet the deadlines. He also knew that not meeting the deadlines may lead to customer dissatisfaction with the risk of loss of business and goodwill. So, he had a meeting with his employees in which accurate and speedy processing of orders was planned. Everybody agreed to work as team because the behaviour of Sonu was positive towards the employees of the organisation. Hence everyone put in extra time and efforts and the targets were met on time. Not only this, Sonu visited Ms.Bimla and advised her to take sufficient rest. (a) Identify the leadership style of sonu Gupta and draw a diagram depicting the style. (b) State any two advantages of the leadership style identified above. Ans. (a) Leadership Style: Democratic / Participative / Group Centered. In the adjoining diagram, A is the leader and B, C, D and E are subordinates.	

	(b) 1. This improves the attitude of the employees towards their jobs and the organization thereby increasing their morale. 2. easy to implement changes	
4	Sunil sales manager, achieved his sales targets one month in advance achievement was displayed on the notice board and a certificate for the best performer was awarded to him by the CEO of the company. (i) Name the incentive provided to Sunil (ii) Identify the type of incentive. (iii) List two other incentives of the type identified in part Answer=(i) Non- financial incentive (ii) Employee- Recognition Programme (iii) (a) Career Advancement Opportunity (b) Job Enrichment	
5	Arjun and Mohit are working in the same organisation but in different department One day at lunch time, Mohit informed Arjun that due to computerization, people are going to be retrenched soon from the organisation. Name, which type of communication is this. State any two limitations of this communication. Answer=Informal communication. The two limitations are: (i) Informal communication often spreads rumours and false facts. (ii) Sometimes confidential information gets disclosed through grapevine.	
6	Meena had been working as an assistant manager with 'Johnson Enterprises' for the and dedication towards the work. When the manager senior to her retired, all her colleagues thought that now meena would be promoted. But to everyone's surprise the vacant post was filled by an outsider, Mrs.Sunita .Meena felt demoralized and her performance started declining. She would abstain herself often and could not meet her targets. also guide and inspire them. She noticed meena s behavior and felt that her performance could be improved. She started involving meena in decision making-issues related to the organization and made her a part of high level	

	joint-management committee. Meena was now punctual in office and her performance started improving (i) Identify the function of management being performed by Sunita (ii) Name the element of the above function of management which helped Sunita to improve Meena's behaviour. (iii) State any three features of the element identified in (ii) above. Answer= (a) Directing (b) Motivation Features of motivation 1- it is an internal feeling 2- can be negative or positive 3- it is a complex process	
7	Pradeep is working in a multi-national company in Noida. He had high fever for the last many days. When his blood was tested, he was found positive for malaria. He was admitted in the hospital and a blood transfusion was advised by the doctors as his condition was very serious. One of his colleagues sent a text message to his superior Mr. B. Chatterjee. Mr. B. Chatterjee, immediately sent a text message to the employees of the organisation requesting them to donate blood for Pradeep. When the General Manager came to know about it he ordered for fumigation in the company premises and for cleaning the surroundings. (a) From the above paragraph quote lines that indicate formal and informal communication (b) State any two features of informal communication. Answer a=(i) Formal communication: When the General Manager came to know about it, he ordered for fumigation in the company premises and for cleaning surroundings. (ii) Informal Communication: 'One of his colleagues sent a text message to his superior Mr. B. Chatterjee'. Mr. B. Chatterjee immediately sent a text message to the employees of the organization requesting them to donate blood for Pradeep (b) Features of Informal Communication: (i) It takes place without following the formal lines of communication. (ii) It arises out of social needs of the employees.	

	(iii) It spreads rapidly. (or any other correct feature)	
8	Rahul , Rajan and Annu , are three friends ,after completing their MBA from a reputed business school at Mumbai, were discussing about the type of organisation they would like to join. Rahul was very clear that he would like to take up a government job as it gives stability about the future income and work which will help him to work with greater zeal. It will also provide him pension when he will retire from his service. Rajan wanted to work in a company, which has appropriate skill development plans for its employees and helps the employees to grow to higher level in the organisation. In addition to this, the company should also provide facilities like housing, medical aid, etc. Annu said that he would prefer to work in an organisation, which has the culture of individual autonomy, is considerate to employees and provides the employees with opportunity for personal growth and a meaningful work experience. (a) Identify the various financial and non-financial incentives discussed by the three friends in the above conversation. (b) Explain three other non-financial incentives which were not discussed by any one of them Answer=(a) The various financial and non-financial incentives discussed by the three friends in the above conversation are: (i) Retirement benefits. (ii) Job security (iii) Career advancement opportunity. (iv) Perquisites. (v) Organisational climate. (vi) Job enrichment (b) Three other non-financial incentives are:	

	(i) Employee empowerment. (iii) Employee recognition. (ii) Employee participation.	
9	Megha was a regional sales manager in 'Good Look Garments Ltd' for ten years. On the retirement of the marketing manager Megha applied for the same post as he was extremely ambitious and had dedicated all her energies to obtain the post marketing manager. However, the top management of the company decided to fill this post by selecting a better person from outside the company. Because of this Megha was heart-broken and her performance declined. When the new marketing manager joined, one of her major problems was how to motivate and inspire Megha to her former level of performance? Suggest any three non-financial incentives that the new marketing manager may use to motivate Megha. Answer= The Non-financial incentives that the new marketing manager may use to motivate Megha are: (a) Status: Status means position or rank of a person in the organisation. The rank of an employee is directly linked with prestige of the job, recognition, his authority, responsibility, rewards and perquisites attached to the job position. (b) Organisation Climate: It refers to the working system within the organisation. It includes individual freedom to function, consideration to employees, reward orientation, risk taking etc. (c) Career Advancement Opportunity: Within the organisation employee can rise at a higher level through promotions. Managers can facilitate this by providing opportunities to the employees to improve their skills, so that they can be promoted to the higher level jobs. This can be done through employee development programmes and appropriate promotion policies.	
10	Discuss six monetary Incentives.	

	Ans. The incentives that have a monetary and financial benefit are called financial incentives. They are- a) Profit sharing: It has been accepted that the profit earned by the firm is also due to the effort put by the workers. So they have a full right to receive a share in it. It is an effective incentive which satisfies the workers. b) Co-partnership: Under this system, employees share the capital as well as the profits. Under employees stock option plan the workers are given shares. They are also given Bonus shares and they share the ownership of the firm. It motivates them as they share the profits too. c) Productivity linked wages: Under this system, a sales person is guaranteed a minimum wage as well as commission on sales. A commission plan motivates him to work better. d) Suggestion system: Valuable suggestions are accepted and the most valuable ones are also rewarded with cash money. e) Retirement benefits: Every employee wants his future to be secured. The firm provides retirement benefits, pension, provident fund, gratuity etc. Perks: various perks such as housing, car allowance foreign trips etc. can be given to the managers to boost up his morale.	
11	Explain various leadership styles. Ans. Autocratic leadership: An autocratic leader gives orders and expects that they are obeyed. He determines the policies for the group without consulting them. All decision making power is centralized with the leader. Democratic leadership: In this style, the leader consults with his subordinates on proposed actions and decisions and encourages them to participate in decision making. This improves the attitude of the employees towards their jobs and increases their morale. Laissez faire leadership: This style gives a high degree of freedom to his subordinates. Group members work themselves as per their own choice and competence. Such a	

	leader avoids use of power. He exists as a contact man with the outsiders to bring information and the resources the group requires for accomplishing the	
12	State any three non- monetary incentives .Ans. Three non-monetary incentives are: (a) Job Enrichment — is a method of motivating employee by making the task to be performed by him more interesting and challenging. The job in itself serves as a source of motivation to the employee and brings out the best in him. (b) Suggestion System — Is a system where suggestions regarding the work procedure, environment are solicited from employees. This increases their participation & importance in the working of the enterprise and hence motivates them. (c) Job Security - refers to making the employee feel safe in his job positions. He is not threatened by transfers or removal from service and hence performs to the best of his abilities	
13	Nikita is posted at lower level management at 'xyz Pvt. Ltd.' The daily sale of the company is about Rs.30 lakhs only. She has given her responsibility that the production work of the company should continue uninterrupted. The managing director has asked her to focus her attention especially on the speed and quality of production she is doing her efficiently. Her reputation is that of a successful leader. She takes every decision after discussing it with all the concerned persons. Her subordinates are happy with her. Identify and explain the leadership style adopted by Nikita . Ans: Democratic leadership style. A democratic leaders respects the suggestion made by employees which leads to greater confidence and cooperation among them.	

CHAPTER – CONTROLLING

Meaning of Controlling

Controlling is the process of comparison of actual work progress with the planned work performance in order to find out the deviations, if any, and removing these deviations by taking corrective action for attainment of objectives according to plans.

Characteristics of Controlling

1. Fundamental function of management: If controlling is eliminated, all other functions of management become meaningless because it ensures that work is going on according to plans.
2. Essential function of every manager: It is that function of management under which every manager at every level get assured that the actual work is in conformity with the plans.
3. Continuous activity: Under controlling, progress has to be assessed continuously against predetermined standards.
4. Related to the Results: It is related to the results because it assess progress on the basis of results and take corrective actions if deviations are found.
5. Both positive and negative Approach: Positive approach of controlling aims at effective use of the available resources. Negative approach aims at preventing misuse of resources.

Importance of Controlling

1. **Accomplishment of organizational goals:** The controlling function measures the progress towards the organizational goals and brings to light the deviations and indicate corrective action.
It thus, guides the organization and keeps it on the right track so that the organizational goals might be achieved.
2. **Judging the accuracy of standards:** A good controlling system enables the management to verify whether the standards set are accurate and objective or not. An effective control system keeps a careful check on the changes taking place in the organization and in the environment and it helps to review & revise the standards in the light of such changes.
3. **Making efficient use of resources:** By exercising control, a manager seeks to reduce wastage of resources. Each activity is performed in accordance with plans. This ensures that resources are used in the most effective and efficient manner.
4. **Improving employees Motivation:** A good control system ensures that employees know well in advance what they are expected to do and what are the performance standards. Thus, it motivates and helps them to give better performance.
5. **Ensures order and discipline:** Controlling creates an atmosphere of order and discipline in the organization. It helps to minimise the dishonest behavior on the part of employees by keeping a close check on their activities.
6. **Facilitates coordination:** Controlling helps to maintain equilibrium between means and ends. It makes sure that all activities and efforts are going in same direction according to pre-determined plans.

Process of Controlling

1. **Setting performance standards:** The first step in the controlling process is setting up performance standards. Standards are the criteria against which actual work performance could be measured. Thus, standards serve as benchmarks towards which an organization strives to work.
Standards can be set in both qualitative as well as quantitative terms.
2. **Measurement of actual performance:** This is the second step of controlling. Actual work done is measured for comparing it with the standards.
There are several techniques of measurement of performance like personal observation, sample checking, performance records etc. As far as possible, performance should be measured in the same unit in which standards are set. This would make their comparison easier.
3. **Comparison of actual performance with standards:** In the third step, actual work performance is compared with standards to find out deviations, if any.

Deviation means the difference between the actual performance and the standard performance. It may be positive or negative.

4. Analyzing deviations: Some deviations in performance can be accepted in all activities. It is therefore, important to determine the acceptable range of deviations. Deviations beyond the permissible limit should be brought to the notice of top level management.

Critical point control and management by exception should be used by the managers in this regard.

5. Taking corrective action: The last but the most important step is to take corrective action. If deviations are found beyond acceptable limits. This may involve modification of plans and standards, training of employees, assigning overtime duties etc.

Critical Point control (CPC)

It is neither economical nor easy to keep a check on each and every activity in the organization. So, Key Result Areas (KRAs) are set as the critical points. If anything goes wrong at the critical points, it must be attended urgently otherwise the entire organization will suffer. This is called critical point control.

For example: In a manufacturing organization an increase of 5% in labour cost may be more troublesome than a 15% increase in postal charges.

Management by Exception (MBE)

Management by Exception is based on the belief that an attempt to control everything results in controlling nothing. Thus, only significant deviations, which are beyond the acceptable limit, should be brought to the notice of management and minor deviations should be ignored.

Thus, if the plans lay down 2% increase in labour cost as an acceptable range of deviations in a manufacturing organization, only increase in labour cost beyond 2% should be brought to the notice of management.

Short Answer Type:

1. Give the meaning of 'Critical Point Control'.

1 mark

Ans. 'Critical Point Control' means focusing on key result areas which are critical to the success of an organization.

2. What is meant by 'Management by Exception' in the process of controlling?

Ans. Management by Exception in the process of controlling means that only significant deviations which go beyond the permissible limit should be brought to the notice of the management.

3. Name the function of management which is concerned with monitoring organizational performance towards the attainment of organizational goals.

Ans. Controlling

4. Name the function of management which reviews the operations in a business unit.

Ans. Controlling

5. Which two aspects of performance are compared controlling?

Ans. In controlling, actual performance is compared with standard performance to find out deviations, if any.

6. Give meaning of the term 'Deviation' as used in the control function of management

Ans. In controlling, 'Deviation' means the difference between actual performance and standard performance.

7. Which principle of management control is based on the belief that an attempt to control everything results in controlling nothing? 1 mark

Ans. Control by exception /Management by exception

8. What do you mean by 'key result areas (KRAs)' in the context of controlling? 1 mark

Ans. KRAs are the critical points which are critical to the success of an organization.

9. In controlling why is actual performance compared with standards? 1 mark

Ans. To find out the deviations, if any.

10. Give two examples of quantitative standards which are set in controlling function of management.

1 mark

Ans. (i) Reduction of defects from 20 in every 1000 pieces produced to 10 in every 1000 pieces produced by the end of the month.

(ii) Target sales volume of Rs.10 lakh per month.

12. Give two examples of qualitative standards which are set in controlling function of management.

1 mark

Ans. (i) Improving customer satisfaction in McDonald's by setting maximum standard waiting time, say, 10 minutes .

(ii) Improving performance of employees by setting standard time to perform a task, say, 2 hours.

13. Name any two techniques for measurement of performance in controlling. 1 mark

Ans. (i) Personal observation (ii) Sample checking

14. "Measurement of performance should be done after the task is completed." Do you agree? 1 mark

Ans. No, measurement of performance should be done continuously during the performance. For example, in case of computer assembling, each part produced should be checked before assembling

15. What is 'Sample Checking' in the context of management control? 1 mark

Ans. In a large organization, it may not be possible to check each and every piece produced. So, certain pieces are checked at random for quality. This is called sample checking.

16. What is important while analysing deviations in controlling? 1 mark

Ans. While analysing deviations, it is important to determine the acceptable range of deviations/Key result areas.

17. When is there no need to take corrective action? 1 mark

Ans. No corrective action is required when the deviations are within acceptable limits.

18. What should be done in case the deviation cannot be corrected through managerial action? 1 mark

Ans. The standards may have to be revised.

19. What should be the 'focus point' for a manager while controlling, as controlling at each and every step is not possible? (CBSE 2011) 1 mark

Ans. Key Result Areas (KRAs)

20. Standards are set in quantitative as well as in qualitative terms. Identify the type of standards when it is set in terms of 'Cost to be incurred'. (CBSE 2012) 1 mark

Ans. Quantitative standards.

21. Why is it said that controlling is blind without planning? 1 mark

Ans. Controlling is blind without planning because if the standards are not set in advance, managers have no basis of controlling.

22. Why is controlling called a backward looking function? 1 mark

Ans. Controlling is like a post-mortem of past activities to find out deviations from the standards. In that sense, controlling is a backward-looking function.

23. Why is it said that planning without controlling is meaningless? 1 mark

Ans. Planning without controlling is meaningless because once a plan becomes operational, controlling is necessary to monitor the progress, measure it, identify and analyse deviations and initiate corrective action to ensure that events conform to plans.

24. How is controlling a forward-looking function? 1 mark

Ans. Controlling is a forward-looking function because the corrective action initiated by it aims to improve future performance.

25. Why is controlling a goal-oriented function? 1 mark

Ans. Controlling is a goal-oriented function because it measures the progress towards the goals, finding

deviations, if any and taking corrective action.

26. Why is controlling a pervasive function?

1 mark

Ans. Controlling is a pervasive function because it is performed in all organisations and at all levels of management.

27. Why is controlling called a continuous process?

1 mark

Ans. Controlling is a continuous process because it involves a constant review of actual performance for taking corrective action, if any.

28. Is controlling the last function of management?

1 mark

Ans. No, controlling is not the last function of management because it brings the-management cycle back to planning function.

Application and HOTS Based

Questions with Answers

1. Babita Ltd. is engaged in manufacturing machine components. The target production is 250 units per day per worker. The company had been successfully attaining this target until two months ago. Over the last two months it has been observed that daily production varies between 200- 210 units per worker.
- (a) Name the function of management and identify the step in the process of this function which helped hi finding out that the actual production of a worker is less than the set target.
- (b) To complete the process of the function identified in (a) and to ensure the performance as per set targets, explain what further steps a manager has to take.

5 marks

Ans. (a) The management function is Controlling.

"Comparing actual performance with standards" is the step involved in the process of controlling which helped in finding out that the actual production of a worker is "less than the set target."

(b) A manager has to take the following two further steps to complete the process of controlling:

(i) Analysing deviations: The deviations from the standards are analysed to identify their causes. While analysing deviations, it is important to determine the acceptable range of deviations and key result areas.

(ii) Taking corrective action: Immediate managerial attention is required so that the deviations do not occur again. If the deviation cannot be corrected through managerial action, the standards may have to be revised.

2. Which two steps in the process of controlling are concerned with compelling events to conform to the plan?

1 mark

Ans. (i) Comparison of actual performance with standards

(ii) Taking corrective action

3. Rajeev and Sanjeev are managers in the same organisation having different units. While discussing about the function of management, Rajeev says "Planning is looking ahead whereas controlling is looking back." But Sanjeev says, "Planning is looking back whereas controlling is looking ahead." Both are giving reasons in favour of their statements.

Explain the possible reasons given by both and justify who is correct.

6 marks

Ans. Rajeev who says, "Planning is looking ahead whereas controlling is looking back" must be

Giving the following reasons:

- Plans are prepared for future and are based on forecasts about future conditions. Therefore, *planning is looking ahead.*
- On the contrary, controlling is like a post-mortem of past activities to find out deviations. In this sense, *controlling is looking back.*

Sanjeev who says, "Planning is looking back whereas controlling is looking ahead" must be giving the following reasons:

- Planning is also looking back because future planning is guided by past experiences.
- Controlling is looking ahead because the corrective action initiated by control function seeks to improve future performance or to revise future plans.

Conclusion: Planning and controlling are both backward looking and forward looking functions. Hence, both of them are partially correct.

4. You are the manager of Bharti Chemicals Ltd. It is reported to you that postal expenses have increased by 10% over standard rates and cost of raw materials has increased by 2%. Which of the two deviations will be more critical to you?

1 mark

Ans. Increase in cost of raw materials by 2 is more critical. (Critical Point Control)

5. Surbhi Ltd. produces safety pins on a mass scale. The company's policy is that at most 2 of the daily production could be defective. Over a three months period; it has been observed that 8 - 10 of the production is defective. The cause of deviation found is defective machinery. What corrective action should be taken by the management?

1 mark

Ans. Repair the existing machine or replace the machine if it cannot be repaired.

6. D&D Ltd. is a large manufacturing unit. Recently, the company has conducted the 'time' and 'motion' studies and concluded that on an average a worker could produce 120 units per day. However, it has been noticed that average daily production of a worker is in the range of 80-90 units.

Which function of management is needed to ensure that the actual performance is in accordance with the performance as per 'time' and 'motion' studies? State four features of this function of

management.

5 marks

Ans. Controlling

Features of controlling:

- (i) Controlling is a goal-oriented function because it involves measuring the progress towards the organisational goals, finding deviations, if any and taking corrective action to ensure achievement of the goals.
- (ii) Controlling is a pervasive function because it is performed in all organisations, whether business or non-business and at all levels of management.
- (iii) Controlling is a continuous process because it involves a constant review of actual performance for taking corrective action, if any.
- (iv) Controlling is both a backward looking as well as forward looking function.

CHAPTER – FINANCIAL MANAGEMENT

Money is needed for carrying out business activities is called business finance. Finance is required to establish a business, to run it, to modernize it, to expand or diversify it.

Financial management is the activity concerned with the planning, raising, controlling and administering of funds used in the business. It is concerned with optimal procurement as well as usage of finance. It aims at ensuring availability of enough funds whenever required as well as avoiding idle finance.

Objectives of Financial Management:

- 1. Wealth Maximization:** The main objective of financial management is to maximize shareholder's wealth, for which achievement of optimum capital structure and proper utilization of funds is a must.
- 2. To procure sufficient funds:** Adequate and regular supply of funds is to be maintained for smooth operations of the business.
- 3. To ensure effective utilization of funds.**
- 4. To ensure safety of funds:** The chances of risk in investments should be minimum.
- 5. To attain optimum capital structure:** A sound and economical combination of shares and debentures must be attempted so as to maintain optimum capital structure.

Role/importance of financial management

- 1) The size and the composition of fixed assets of the business.
- 2) The quantum of current assets and its break-up into cash, inventory and Receivables.
- 3) The amount of long-term and short term funds to be used.
- 4) Break-up of long-term financing into debt, equity.

5) All items in the Profit and Loss Account, e.g., Interest, Expense, Depreciation, etc.

Financial Decisions:

Every company is required to take three main financial decisions which are as follows:

1. Investment Decision: It relates to how the firm's funds are invested in different assets. Investment decision can be long-term or short-term. A long term investment decision is called capital budgeting decision as they involve huge amounts of funds and are irreversible except at a huge cost while short term investment decisions are called working capital decisions, which affect day to day working of a business.

Factors affecting Investment Decisions/Capital Budgeting decisions

- 1. Cash flows of the project:** The series of cash receipts and payments over the life of an investment proposal should be considered and analyzed for selecting the best proposal.
- 2. Rate of Return:** The expected returns from each proposal and risk involved in them should be taken into account to select the best proposal.
- 3. Investment Criteria Involved:** The various investment proposals are evaluated on the basis of capital budgeting techniques. These involve calculation regarding investment amount, interest rate, cash flows, rate of return etc.

2Financing Decision:

It relates to the amount of finance to be raised from various long term sources. The main sources of funds are owner's funds i.e. equity or shareholder's funds and the borrowed funds i.e. Debts. Borrowed funds have to be repaid at a fixed time and thus some amount of financial risk (i.e. risk of default on payment) is there in debt financing. Moreover, interest on borrowed funds has to be paid regardless of whether or not a firm has made a profit. On the other hand, shareholder's fund involves no commitment regarding payment of returns or repayment of capital. A firm mix both debt and equity in making financing decisions.

Factors Affecting Financing Decision:

- 1. Cost:** The cost of raising funds from different sources are different. The cheapest source should be selected.
- 2. Risk:** The risk associated with different sources is different. More risk is associated with borrowed funds as compared to owner's fund as interest is paid on it and it is repaid also, after a fixed period of time or on expiry of its; tenure.

3. Flotation Cost: The costs involved in issuing securities such as brokers commission, underwriters' fees, expenses on prospectus etc. are called flotation costs. Higher the flotation cost, less attractive is the source of finance.

4. Cash flow position of the business: In case the cash flow position of a company is good enough then it can easily use borrowed funds and pay interest on time.

5. Control Considerations: In case the existing shareholders want to retain the complete control of business then finance can be raised through borrowed funds but when they are ready for dilution of control over business, equity can be used for raising finance.

6. State of Capital Markets: During boom, finance can easily be raised by issuing shares but during depression period, raising finance by means of debt is easy.

7. Period of Finance: For permanent capital requirement, Equity shares must be issued as they are not to be paid back and for long and medium term requirement, preference shares or debentures can be issued.

3Dividend Decision: Dividend refers to that part of the profit which is distributed to shareholders. A company is required to decide how much of the profit earned by it should be distributed among shareholders and how much should be retained. The decision regarding dividend should be taken keeping in view the overall objective of maximizing shareholder's wealth.

Factors affecting Dividend Decision:

1. Earnings: Companies having high and stable earning could declare high rate of dividends as dividends are paid out of current and past earnings.

2. Stability of Dividends: Companies generally follow the policy of stable dividend. The dividend per share is not altered and changed in case earnings change by small proportion or increase in earnings is temporary in nature.

3.Growth Prospects: In case there are growth prospects for the company in the near future then it will retain its earning and thus, no or less dividend will be declared.

4.Cash Flow Positions: Dividends involve an outflow of cash and thus, availability of adequate cash is for most requirement for declaration of dividends.

5 Preference of Shareholders: While deciding about dividend the preference of shareholders is also taken into account. In case shareholders desire for dividend then company may go for declaring the same.

6. Taxation Policy: A company is required to pay tax on dividend declared by it. If tax on dividend is higher, company will prefer to pay less by way of dividends whereas if tax rates are lower than more dividends can be declared by the company.

7. Stock Market Reaction: Investors, in general, view an increase in dividend as a good news and stock prices react positively to it.

8 Legal constraints: Under provisions of Companies Act, all earnings can't be distributed and the company has to provide for various reserves. This limits the capacity of company to declare dividend.

9. Access to Capital Market: Large and reputed companies generally have easy access to the capital market and, therefore, may depend less on retained earning to finance their growth.

10) Stability of Earnings: Other things remaining the same, a company having stable earning is in a position to declare higher dividend. As against this, a company having unstable earnings is likely to pay smaller dividend.

11) Contractual Constraints: While granting loans to a company, sometimes the lender may impose certain restrictions on the payment of dividends in future.

Financial Planning:

The process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning. It ensures that enough funds are available at right time so that a firm could honor its commitments and carry out its plans.

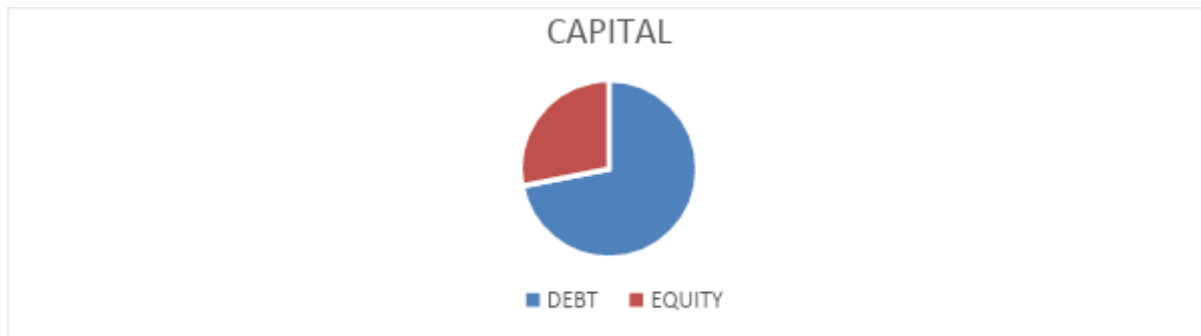
Importance of Financial Planning:

1. To ensure availability of adequate funds at right time.
2. To see that the firm does not raise funds unnecessarily.
3. It provides policies and procedures for the sound administration of finance function.
4. It results in preparation of plans for future. Thus new projects can be under taken smoothly.
5. It attempts to achieve a balance between inflow and outflow of funds. Adequate liquidity is ensured throughout the year.
6. It serves as the basis of financial control. The management attempts to ensure utilization of funds in tune with the financial plans.

Capital Structure:

Capital structure refers to the mix between owner's funds and borrowed funds. It will be said to be optimal when the proportion of debt and equity is such that it results in an increase in the value of the equity share. The proportion of debt in the overall capital of a firm is called Financial Leverage or Capital Gearing. When the proportion

of debt in the total capital is high then the firm will be called highly levered firm but when the proportion of debts in the total capital is less, then the firm will be called low levered firm.



Trading on Equity: It refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges like interest. Trading on equity happens when the rate of earning of an organization is higher than the cost at which funds have been borrowed and as a result equity shareholders get higher rate of dividend per share.

The use of more debt along with the equity increases EPS as the debt carries fixed amount of interest which is tax deductible. Let us understand with an example:

For example a company has Rs. 10 crores capital. Option 1 the company uses only equity capital option 2 the company uses 50% equity and 50% debt capital in its capital structure. Rate of interest on debt is 15%. Rate of company uses 50% debt capital in its capital structure. Rate of interest on debt is 15%. Rate of Income – tax is 30%.profit before interest and tax is Rs.2 crores.

Particulars	Option1	Option 2
Profit before interest and taxes (PBIT)	2,00,00,000	2,00,00,000
Less: Interest on debt	-----	15,00,000
Profit after tax	2,00,00,000	1,85,00,000
Less: Income – tax @30%	60,00,000	55,50,000
Profit after tax and interest	1,40,00,000	1,29,50,000
No. of equity shares (FV Rs.10 each)	20,00,000	10,00,000
Return to shareholders(EPS)	Rs.7	Rs.12.95

OPTION 2 has higher EPS . Debts are higher in this situation, trading on equity comes only when ROI is greater then cost of debts.

Factors determining the choice of capital structure are as follows:

1) Cash Flow Position: In case a company has strong cash flow position then it may raise finance by issuing debts, as they are to be paid back after some time.

2. Interest Coverage Ratio: It refers to the number of times earnings before interest and taxes of a company covers the interest obligation. High Interest coverage ratio indicates that company can have more of borrowed funds. Formula for calculating ICR = $\text{EBIT} / \text{interest}$.

3)Debt Service Coverage Ratio (DSCR): Debt Service Coverage Ratio takes care of the deficiencies referred to in the Interest Coverage Ratio (ICR). Higher DSCR indicates better ability to meet cash commitments and consequently, the company's potential to increase debt component in its capital structure.

4. Return on Investment: If return on investment is higher than the rate of interest on debt then it will be beneficial for a firm to raise finance through borrowed funds.

5. Floatation Cost: The cost involved in issuing securities such as brokers' commission, under-writers' fees, cost of prospectus etc. is called flotation cost. While selecting the source of finance, flotation cost should be taken into account.

6. Control: When existing shareholders are ready to dilute their control over the firm then new equity shares can be issued for raising finance but in reverse situation debts should be used.

7. Tax Rate: Interest on debt is allowed as a deduction; thus in case of high tax rate, debts are preferred over equity but in case of low tax rate more preference is given to equity.
Company X Company Y.

8. Flexibility: A good financial structure should be flexible enough to have scope for expansion or contraction of capitalization whenever the need arises. Issue of debenture and preference shares brings flexibility.

9. Capital Market Conditions: Conditions prevailing in capital market influences the determination of securities to be issued. Like during depression, people do not like to take risk and so are not interested in equity shares but during boom, investors are ready to take risk and invest inequity shares.

10. Cost of debt: A firm's ability to borrow at a lower rate increases its capacity to employ higher debt. Thus, more debt can be used if debt can be raised at a lower rate.

11) Cost of Equity: Stock owners expect a rate of return from the equity which is commensurate with the risk they are assuming. When a company increases debt, the financial risk faced by the equity holders, increases.

12) Risk Consideration: As discussed earlier, use of debt increases the financial risk of a business.

13) Regulatory Framework: Every company operates within a regulatory framework provided by the law e.g., public issue of shares and debentures has to be made under SEBI guidelines.

14) Stock market conditions: If the stock markets are bullish, equity shares are more easily sold even at a higher price. However, during a bearish phase, a company may find raising of equity capital more difficult and it may opt for debt.

Fixed Capital: Fixed capital refers to investment in long-term assets. Investment in fixed assets is for longer duration and they must be financed through long-term sources of capital. Decisions relating to fixed capital involve huge capital funds and are not reversible without incurring heavy losses.

Factors Affecting Requirement of Fixed Capital:

1. Nature of Business: Manufacturing concerns require huge investment in fixed assets & thus huge fixed capital is required for them but trading concerns need less fixed capital as they are not required to purchase plant and machinery etc.

2. Scale of Operations: An organization operating on large scale requires more fixed capital as compared to an organization operating on small scale.

For Example - A large scale steel enterprise like TISCO requires large investment as compared to a mini steel plant.

3. Choice of Technique: An organization using capital intensive techniques requires more investment in plant & machinery as compared to an organization using labour intensive techniques.

4. Technology upgradation: Organizations using assets which become obsolete faster require more fixed capital as compared to other organizations.

5. Growth Prospects: Companies having more growth plans require more fixed capital. In order to expand production capacity more plant & machinery are required.

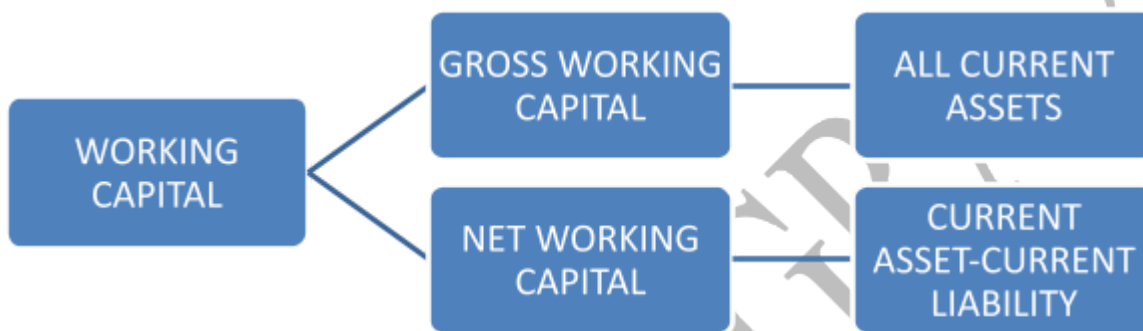
6. Diversification: In case a company goes for diversification then it will require more fixed capital to invest in fixed assets like plant and machinery.

7. Distribution Channels: The firm which sells its product through wholesalers and retailers requires less fixed capital.

8. Collaboration: If companies are under collaboration, Joint venture, then they need less

fixed capital as they share plant & machinery with their collaborators.

Working Capital: Working Capital refers to the capital required for day to day working of an organization. Apart from the investment in fixed assets every business organization needs to invest in current assets, which can be converted into cash or cash equivalents within a period of one year. They provide liquidity to the business. Working capital is of two types –



Gross working capital and Net working capital. Investment in all the current assets is called Gross Working Capital whereas the excess of current assets over current liabilities is called Net Working Capital. Following are the factors which affect working capital requirements of an organization:

- 1. Nature of Business:** A trading organization needs a lower amount of working capital as compared to a manufacturing organization, as trading organization undertakes no processing work.
- 2. Scale of Operations:** An organization operating on large scale will require more inventory and thus, its working capital requirement will be more as compared to small organization.
- 3. Business Cycle:** In the time of boom more production will be undertaken and so more working capital will be required during that time as compared to depression.
- 4. Seasonal Factors:** During peak season demand of a product will be high and thus high working capital will be required as compared to lean season.

5. Credit Allowed: If credit is allowed by a concern to its customers than it will require more working capital but if goods are sold on cash basis than less working capital is required.

6. Credit Availed: If a firm is able to purchase raw materials on credit from its suppliers than less working capital will be required.

7. Price Level Changes: Working capital requirement is also determined by price level changes. For example, during inflation prices of raw material, wages also rise resulting in increase in working capital requirements.

8. Turnover of Working Capital: Turnover means speed with which the working capital is converted into cash by sale of goods. If it is speedier, the amount of working capital required will be less.

9. Availability of Raw Material: If the raw materials and other required materials are available freely and continuously, lower stock levels may be sufficient. If, however, raw materials do not have a record of un-interrupted availability, higher stock levels may be required.

10. Growth Prospects: If the growth potential of a concern is perceived to be higher, it will require larger amount of working capital so that it is able to meet higher production and sales target whenever required.

11. Level of Competition: Level of competitiveness may necessitate larger stocks of finished goods to meet urgent orders from customers. This increases the working capital requirement.

12. Inflation: With rising prices, larger amounts are required even to maintain a constant volume of production and sales. The working capital requirement of a business thus, becomes higher with higher rate of inflation.

	SHORT ANSWER TYPE QUESTIONS	
1	What is financial risk? Why does it arise? Ans: Financial risk refers to a situation when a company is not able to meet its fixed financial charges such as interest payment, preferred dividend and repayment obligations. It refers to the probability that the company would not be able to meet its fixed financial obligations. It arises when the proportion of debt in the capital structure increases. It is obligatory for the company to pay the interest charges on debt.	

	along with the principal amount. Thus, higher the debt, higher will be its payment obligations and higher would be the chances of default on payment. Hence, higher use of debt leads to higher financial risk for the company.	
2	What is meant by capital structure? Ans: Capital Structure means the proportion of debt and equity used for financing the operations of business. In other words, capital structure represents the proportion of debt capital and equity in the capital structure. The capital structure should be such which increase the value of equity share or maximizes the wealth of equity shareholders.	
3	Financial management is based on three broad financial decisions. What are these? Ans: Financial management refers to the efficient acquisition, allocation and usage of funds of the company. The three financial decisions are: 1. Investment decision includes investment in fixed assets (capital budgeting decisions) and current assets (working capital decisions) 2. Financing decision - They relate to the raising of finance from various resources depend upon decision on type of source (owned funds and borrowed funds), period of financing, cost of financing and the returns thereby. 3. Dividend decision - The finance manager has to take decision as to how much to be distributed as dividend and how much to be kept as retained earnings with regards to the net profit distribution.	
4	Discuss the two objectives of Financial Planning. Ans: Financial Planning involves designing the blueprint of the financial operations of a firm. The following are the two highlighted objectives of financial planning.	

	1. To ensure availability of funds whenever these are required: The main objective of financial planning is that sufficient fund should be available in the company for different purposes such as for purchase of long- term assets, to meet day to day expenses etc. 2. To see that firm does not raise resources unnecessarily: Excess funding is as bad as inadequate or shortage of funds. If there is surplus money, it is to be invested in the best possible manner as keeping idle financial resources lead to loss.	
5	After pursuing a course in event management, Kajal and her brother Kamal promoted an event management company under the name Khushi Entertainment Private Limited. They strive together as dedicated and dynamic professionals managing different kinds of formal and informal events across all major cities in India and abroad. They design the event idea and co-ordinate the different aspects of the event to make it a grand success. As a policy, they take fifty percent of the payment as advance from the client before the start of an event and receive the balance charges after the successful completion of the event. In context of the above case: 1. Comment upon the working capital needs of the company keeping in mind its nature of business. 2. Identify the other factor mentioned in the paragraph which is likely to affect the working capital requirement of their business. Answer: 1. The working capital requirements of Khushi Entertainment Private Limited will be relatively less as they are engaged in providing event management services, wherein there is no need to maintain inventory The other factor mentioned in the paragraph which is likely to affect the working capital requirement of their business is 'Credit availed.' Since as a policy, they take fifty percent of the payment as advance from the client before the start of an event, their requirement of working capital is reduced.	

6	Wireworks Ltd. is a company manufacturing different kinds of wires. Despite fierce competition in the industry, it has been able to maintain stability in its earnings and as a policy, uses 30% of its profits to distribute dividends. The small investors are very happy with the company as it has been declaring high and stable dividend over past five years. In context of the above case: 1. State any one reason because of which the company has been able to declare high dividend by quoting line from the paragraph. 2. Why do you think small investors are happy with the company for declaring stable dividend? Answer: 1. Stability in earnings: The company has been able to declare high dividend because its earnings are stable. 2. "Despite fierce competition in the industry, it has been able to maintain stability in its earnings." 3. The small investors are happy with the company for declaring stable dividend as they enjoy a regular income on their investment.	
7	Amar is doing his transport business in Delhi. His buses are generally used for tourists going to Jaipur and Agra. Identify the working capital requirements of Amar. Give reasons to support your answer. Further, Amar wants to expand and diversify his transport business. Explain any two factors that will affect his fixed capital requirements. Answer:	

	1. The working capital requirements of Amar will be relatively less as he is engaged in providing transport services wherein there is no need to maintain inventory. 2. The factors affecting the fixed capital needs of his business are as follows: ○ Diversification: If a business enterprise plans to diversify into new product lines, its requirement of fixed capital will increase. ○ Growth prospects: If a business enterprise plans to expand its current business operations in the anticipation of higher demand, consequently, more fixed capital will be needed by it.	
8	Manish is engaged in the business of manufacturing garments. Generally, he used to sell his garments in Delhi. Identify the working capital requirements of Manish giving reason in support of your answer. Further, Manish wants to expand and diversify his garments business. Explain any two factors that will affect his fixed capital requirements. Answer: 1. The working capital requirements of Manish will be relatively more as he is engaged in the business of manufacturing garments. This is because the length of production cycle is longer i.e. it takes time to convert raw material into finished goods. 2. The factors affecting the fixed capital needs of his business are as follows: ○ Scale of Operations: The amount of fixed capital required by a business enterprise is directly proportionate to its scale of operations. Therefore, if Manish plans to do business on a large scale, his fixed capital requirements will be more or vice versa. ○ Technological Upgradation: If Manish plans to use machines of latest technology in manufacturing garments, his fixed capital requirements will be more as replacement of obsolete machines will require huge financial outlay.	

9	Harish is engaged in the warehousing business and his warehouses are generally used by businessmen to store fruits. Identify the working capital requirements of Harish giving reasons in support of your answer. Further, Harish wants to expand and diversify his warehousing business. Explain any two factors that will affect his fixed capital requirements. Answer: 1. The working capital requirements of Harish will be relatively less as he is engaged in providing warehousing services wherein there is no need to maintain inventory. 2. The factors affecting the fixed capital needs of his business are as follows: ○ Diversification: If a business enterprise plans to diversify into new product lines, its requirement of fixed capital will increase. ○ Scale of Operations: The amount of fixed capital required by a business enterprise is directly proportionate to its scale of operations. Therefore, if Harish plans to do business on a large scale his fixed capital requirement will be more or vice versa.	
10	Manoj is a renowned businessman involved in export business of leather goods. As a responsible citizen, he chooses to use jute bags for packaging instead of plastic bags. Moreover, on the advice of his friends, he decides to use jute for manufacturing aesthetic handicrafts, keeping in view the growing demand for natural goods. In order to implement his plan, after conducting a feasibility study, he decides to set up a separate manufacturing unit for producing varied jute products. In context of the above case: 1. Identify the type of investment decision taken by Manoj by deciding to set up a separate manufacturing unit for producing jute products. 2. State any two factors that he is likely to consider while taking this decision	

	Answer: 1. Capital budgeting decision has been taken by Manoj. 2. The two factors affecting Capital Budgeting Decision are as follows: a) Cash inflows: The expected cash inflows from the proposed projects should be carefully analysed and the project indicating higher cash inflows should be selected. b) Rate of return: The expected rate of return should be carefully studied in terms of risk associated from the proposed project. If two projects are likely to offer the same rate of return, the project involving lesser risk should be selected.	
	LONG ANSWER TYPE & CASE STUDIES	
1	Somnath Ltd. is engaged in the business of export of garments. In the past, the performance of the company had been up to the expectations. In line with the latest technology, the company decided to upgrade its machinery. For this, the Finance Manager, Dalmia estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Dalmia therefore, began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds he is trying to find out alternative sources from outside. Identify the financial concept discussed in the above para. Also state the objectives to be achieved by the use of financial concept, so identified. Answer: Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organisation's future operations. The objectives to be achieved by the use of financial concept are stated below:	

	• To ensure availability of funds whenever required which involves estimation of the funds required, the time at which these funds are to be made available and the sources of these funds. • To see that the firm does not raise resources unnecessarily as excess funding is almost as bad as inadequate funding. Financial planning ensures that enough funds are available at right time	
2	Ramnath Ltd. is dealing in import of organic food items in bulk. The company sells the items in smaller quantities in attractive packages. Performance of the company has been up to the expectations in the past. Keeping up with the latest packaging technology, the company decided to upgrade its machinery. For this, the Finance Manager of the company, Mr. Vikrant estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Therefore, Mr. Vikrant began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources. For the remaining funds he is trying to find out alternative sources. Identify the financial concept discussed in the above paragraph. Also, state any two points of importance of the financial concept, so identified. (CBSE, OD 2017) Answer: 1. Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organisation's future operations. 2. The two points highlighting the importance of planning are described below: ○ It ensures smooth running of a business enterprise by ensuring availability of funds at the right time. ○ It helps in anticipating future requirements of a funds and evading business shocks and surprises .	

3	“A business that doesn’t grow dies”, says Mr. Shah, the owner of Shah Marble Ltd. with glorious 36 months of its grand success having a capital base of RS.80 crores. Within a short span of time, the company could generate cash flow which not only covered fixed cash payment obligations but also create sufficient buffer. The company is on the growth path and a new breed of consumers is eager to buy the Italian marble sold by Shah Marble Ltd. To meet the increasing demand, Mr. Shah decided to expand his business by acquiring a mine. This required an investment of RS.120 crores. To seek advice in this matter, he called his financial advisor Mr. Seth who advised him about the judicious mix of equity (40%) and Debt (60%). Mr. Seth also suggested him to take loan from a financial institution as the cost of raising funds from financial institutions is low. Though this will increase the financial risk but will also raise the return to equity shareholders. He also apprised him that issue of debt will not dilute the control of equity shareholders. At the same time, the interest on loan is a tax deductible expense for computation of tax liability. After due deliberations with Mr. Seth, Mr. Shah decided to raise funds from a financial institution. Identify and explain the concept of Financial Management as advised by Mr. Seth in the above situation. State the four factors affecting the concept as identified in part (1) above which have been discussed between Mr. Shah and Mr. Seth. Answer: 1. Capital structure is the concept of Financial Management as advised by Mr. Seth in the above situation. Capital structure refers to the mix between owner’s funds and borrowed funds. 2. The four factors affecting capital structure which have been discussed between Mr. Shah and Mr. Seth are explained below: ○ Cashflow position: The issue of debt capital involves a fixed burden on the company in the form of payment of interest and repayment of capital. Therefore, if the cash flow position of a company is good it may issue debt else equity to raise the required amount of capital.
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	○ Risk Consideration: Financial risk refers to a situation when a company is unable to meet its fixed financial charges. Financial risk of the company increases with the higher use of debt. This is because issue of debt involves fixed commitment in terms of payment of interest and repayment of capital. ○ Tax rate: Considering the fact that amount of interest paid is a deductible expense, cost of debt is affected by the tax rate. ○ Control: The issue of debentures doesn't affect the control of the equity shareholders over the business as the debenture holders do not have the right to participate in the management of the business.	
4	Shalini, after acquiring a degree in Hotel Management and Business Administration, took over her family food processing company of manufacturing pickles, jams and squashes. The business had been established by her great grandmother and was doing reasonably well. However, the fixed operating costs of the business were high and the cash flow position was weak. She wanted to undertake modernisation of the existing business to introduce the latest manufacturing processes and diversify into the market of chocolates and candies. She was very enthusiastic and approached a finance consultant, who told her that approximately ₹ 50 lakh would be required for undertaking the modernisation and expansion programme. He also informed her that the stock market was going through a bullish phase. 1. Keeping the above considerations in mind, name the source of finance Shalini should not choose for financing the modernisation and expansion of her food processing business. Give one reason in support of your answer. 2. Explain any two other factors, apart from those stated in the above situation, which Shalini should keep in mind while taking this decision. Answer: 1. Shalini should not choose debt capital for financing the modernisation and expansion of her food processing business because the fixed operating cost of the company is high. It cannot take the additional burden of fixed	

	commitments in terms of payment of interest and repayment of capital by issuing debt. 2. The other two factors that Shalini must keep in mind while taking this decision are stated below: ○ Risk: Financial risk refers to a situation when a company is unable to meet its fixed financial charges. Financial risk of the company increases with the higher use of debt. This is because issue of debt involves fixed commitment in terms of payment of interest and repayment of capital. ○ Flexibility: Too much dependence on debt reduces the firm's ability to raise debt during unexpected situations. Therefore, it should maintain flexibility by not using debt to its full potential.	
5	'Apparels' is India's second largest manufacturer of branded Lifestyle apparel. The company now plans to diversify into personal care segment by launching perfumes, hair care and skin care products. Moreover, it is planning to open ten exclusive retail outlets in various cities across the country in next two years. In context of the above case: 1. Identify the two factors affecting the fixed capital needs of the company by quoting lines from the paragraph. 2. Why is the management of fixed capital considered to be an important for a business? Answer: 1. The factors affecting the fixed capital needs of the company are as follows: ○ Diversification: If a business enterprise plans to diversify into new product lines, its requirement of fixed capital will increase. ○ Growth prospects: If a business enterprise plans to expand its current business operations in the anticipation of higher demand, consequently, more fixed capital will be needed by it.	

	2. The management of fixed capital is considered important because: ○ It affects the growth and profitability of business in future. ○ It involves huge investment outlay in terms of investment in land, building, machinery etc. ○ It influences the overall level of business risk of the organisation. ○ If these decisions are reversed, they may lead to major losses.	
6	Tata International Ltd. earned a net profit of Rs. 50 crores. Ankit, the finance manager of Tata International Ltd. wants to decide how to appropriate these profits. Discuss any five factors which will help him in taking this decision. (CBSE, Sample Paper, 2015) Answer: The five factors which will help Ankit, in taking the dividend decision are described below: ● Earnings: Since the dividends are paid out of current and past earnings, there is a direct relationship between the amount of earnings of the company and the rate at which it declares dividend. If the earnings of the company are high, it may declare a higher dividend or vice-versa. ● Cash flow position: Since the dividends are paid in cash, if the cash flow position of the company is good it may declare higher dividend or vice-versa. ● Access to capital market: If the company enjoys an easy access to capital market because of its credit worthiness. It does not feel the need to depend entirely on retained earnings to meet its financial needs. Hence, it may declare higher dividend or vice-versa. ● Growth prospects: If the company has any forthcoming investment opportunities, it may like to retain profits to finance its expansion projects. This is because retained profits is considered to be the cheapest source of finance as it doesn't involve any explicit costs. Hence, it may declare lower dividend or vice-versa.	

	Preferences of the shareholders: The companies paying stable dividends are always preferred by small investors primarily if they want regular income in the form of 'stable returns' from their investments. Large shareholders may be willing to forgo their present dividend in pursuit of higher profits in future. Therefore, the preferences of the shareholders must be taken into consideration.	
7	'Abhishek Ltd' is manufacturing cotton clothes. It has been consistently earning good profits for many years. This year too, it has been able to generate enough profits. There is availability of enough cash in the company and good prospects for growth in future. It is a well-managed organisation and believes in quality, equal employment opportunities and good remuneration practices. It has many shareholders who prefer to receive a regular income from their investments. It has taken a loan of Rs. 50 lakhs from ICICI Bank and is bound by certain restrictions on the payment of dividend according to the terms of the loan agreement. The above discussion about the company leads to various factors which decide how much of the profits should be retained and how much has to be distributed by the company. Quoting the lines from the above discussion, identify and explain any four such factors. Answer: The five factors which Ankit has to consider before taking dividend decisions are: 1. Growth Opportunities: Financial needs of a firm are directly related to the investment opportunities available to it. If a firm has abundant profitable investment opportunities, it will adopt a policy of distributing lower dividends. It would like to retain a large part of its earnings because it can reinvest them at a higher rate. 2. Stability of Dividends: Investors always prefer a stable dividend policy. They expect to get a fixed amount as dividends which should increase gradually over the years. 3. Legal Restrictions: A firm's dividend policy has to be formulated within the legal provisions and restrictions of the Indian Companies Act.	

	4. Restrictions in Loan Agreements: Lenders, mostly financial institutions, put certain restrictions on the payment of dividends to safeguard their interests. 5. Liquidity: The cash position is a significant factor in determining the size of dividends. Higher the cash and overall liquidity position of a firm, higher will be its ability to pay dividends.	
8	Arun is a successful businessman in the paper industry. During his recent visit to his friend's place in Mysore, he was fascinated by the exclusive variety of incense sticks available there. His friend tells him that Mysore region is known as a pioneer in the activity of Agarbatti manufacturing because it has a natural reserve of forest products especially Sandalwood to provide for the base material used in production. Moreover, the suppliers of other types of raw material needed for production follow a liberal credit policy and the time required to manufacture incense sticks is relatively less. Considering the various factors, Arun decides to venture into this line of business by setting up a manufacturing unit in Mysore. In context of the above case: 1. Identify and explain the type of financial decision taken by Arun. 2. Identify the three factors mentioned in the paragraph which are likely to affect the working capital requirements of his business. Answer: 1. Investment decision has been taken by Arun. Investment decision seeks to determine as to how the firm's funds are invested in different assets. It helps to evaluate new investment proposals and select the best option on the basis of associated risk and return. Investment decision can be long term or short-term. A long-term investment decision is also called a Capital Budgeting decision 2. The three factors mentioned in the paragraph which are likely to reduce the working capital requirements of his business are as follows: . ○ Availability of raw material: As there is easy availability of Sandalwood which is used as the base material for production, the working capital	

	requirements of his business will be less as there is no need to stock the raw materials. ○ Production cycle: The production cycle is shorter and less time is required to manufacture incense sticks. Thus, the working capital requirements of his business will be low. ○ Credit availed: Due to the fact that the suppliers of other types of raw material needed for production follow a liberal credit policy, the business can be operated on minimum working capital.	
9	‘Aditya’ is a company enjoying market leadership in the food brands segment. Its portfolio includes three categories in the Foods business namely Snack Foods, Juices and Confectionery. Keeping in line with the growing demand for packaged food it now plans to introduce Ready- to-Eat Foods. Therefore, the company has planned to undertake investments of nearly Rs. 450 crores for its new line of business. As per the current financial report, the interest coverage ratio of the company and return on investment is higher. Moreover, the corporate tax rate is high. In context of the above case: 1. As a financial manager of the company, which source of finance will you opt for debt or equity, to raise the required amount of capital? Explain by giving any two suitable reasons in support of. your answer. 2. Why are the shareholders of the company likely to gain from the issue of debt by the company? Answer: 1. As a financial manager of the company, I will opt for debt to raise the required amount of capital. 2. I support my decision by giving the following reasons: ○ Interest coverage ratio: The interest coverage ratio of the company is high so it can easily meet its fixed commitment of payment of interest and repayment of capital.	

	○ Tax rate: The tax rate is high which makes debt relatively cheaper as the amount of interest paid on debt is treated as a tax deductible expense. ○ The shareholders of the company are likely to gain from the issue of debt by the company because the return on investment is higher. It helps a company to take advantage of trading on equity to increase the earnings per share.	
10	Computer Tech Ltd. is one of the leading information technology outsourcing services providers in India. The company provides business consultancy and outsourcing services to its clients. Over the past five years the company has been paying dividends at high rate to its shareholders. However, this year, although the earnings of the company are high, its liquidity position is not so good. Moreover, the company plans to undertake new ventures in order to expand its business. In context of the above case: 1. Give any three reasons because of which you think Computer Tech Ltd. has been paying dividends at high rate to its shareholders over the past five years. 2. Comment upon the likely dividend policy of the company this year by stating any two reasons in support of your answer. Answer: 1. Computer Tech Ltd. has been paying dividends at high rate to its shareholders over the past five years because of the following reasons: ○ Earnings: The earnings of the company have been high. Since the dividends are paid out of current and past earnings, there is a direct relationship between the amount of earnings of the company and the rate at which it declares dividend. ○ Cashflow position: The cash flow position of the company must have been good as in order to pay high dividends, more cash is required. ○ Access to capital market: Because of its credit worthiness, the company enjoyed an easy access to capital market. Therefore, it did not feel the	

	need to depend entirely on retained earnings to meet its financial needs. Hence, it declared higher dividends in past. 2. This year the company is likely to follow a conservative dividend policy because of the following reasons: ○ The cash flow position of the company is not good and dividends are paid in cash. ○ The company may like to retain profits to finance its expansion projects. Retained profits do not involve any explicit cost and hence considered to be the cheapest source of finance.	
11	Bhuvan inherited a very large area of agricultural land in Haryana after the death of his grandfather. He plans to sell this piece of land and use the money to set up a small scale paper factory to manufacture all kinds of stationary items from recycled paper. Being an amateur in business, he decides to consult his friend Subhash who works in a financial consultancy firm. Subhash helps him to prepare a blue-print of his future business operations on the basis of sales forecast in next five years. Based on these estimates, he helps Bhuvan to assess the fixed and working capital requirements of business. In context of the above case: 1. Identify the type of financial service that Subhash has offered to Bhuvan. 2. Briefly state any four points highlighting the importance of the type of financial service identified in part (1). Answer: 1. Financial planning is the type of financial service that Subhash has offered to Bhuvan. 2. The four points highlighting the importance of financial planning are as follows: ○ It ensures smooth running of a business enterprise by ensuring availability of funds at the right time.	

	○ It helps in anticipating future requirements of a funds and evading business shocks and surprises. ○ It facilitates co-ordination among various departments of an enterprise like marketing and production functions, through well-defined policies and procedures. ○ It increases the efficiency of operations by curbing wastage of funds, duplication of efforts, and gaps in planning.	
12	‘Madhur Milan’ is a popular online matrimonial portal. It seeks to provide personalized match making service. The company has 80 offices in India, and is now planning to open offices in Singapore, Dubai and Canada to cater to its customers beyond the country. The company has decided to opt for the sources of equity capital to raise the required amount of capital. In context of the above case: 1. Identify and explain the type of risk which increases with the higher use of debt. 2. Explain briefly any four factors because of which you think the company has decided to opt for equity capital. Answer: 1. Financial risk of the company increases with the higher use of debt. This is because issue of debt involves fixed commitment in terms of payment of interest and repayment of capital. Financial risk refers to a situation when a company is unable to meet its fixed financial charges. 2. The factors because of which the company has decided to opt for equity capital are as follows: ○ Capital market conditions: The state of capital market is bullish, so people are likely to invest more in equity.	

	○ Fixed operating cost: The fixed operating cost of company is high so it cannot take the further burden fixed commitment in terms of payment of interest and repayment of capital by issuing debt. ○ Cashflow position: The cash flow position of the company is weak so it cannot meet the fixed obligations involved in issue of debt. ○ Risk: The proportion of debt in its capital structure is already high so it cannot issue further debt, thereby endangering the solvency of the company	
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CHAPTER – FINANCIAL MARKETS

Financial Market

A financial market is a market for the creation & exchange of financial assets. Financial market exists wherever a financial transaction occurs.

Function of Financial Markets

Financial market performs the following important function:

1. **Mobilisation of savings and channelization into most productive uses:** A financial market facilitates the transfer of savings from savers to investors. It gives savers the choice of different investment captions and thus helps to channelise surplus funds into most productive uses.
2. **Facilitates Price discovery:** Price of anything depends upon its demand and supply. It in the financial market the households are suppliers of firm and business firm represent the demand.
3. The interaction between them helps to establish a price for the financial assets which is being traded in that particular market.

4. **Provided liquidity to financial Assets:** Financial market facilitates easy purchase and sale of financial assets. In doing so they provide liquidity to financial assets; so that they can be easily converted into cash whenever required.
5. **Reduce the cost of transaction:** Financial market provides valuable information regarding price, cost and availability of various securities. It helps to save time, efforts and money. That both buyers & sellers would have to be spending for getting information and finding each other.

Classification of financial market/segments of financial market

On the basis of maturity of financial instrument credit, financial market can be classified into money market & capital market.

Capital Market

A market which deals in medium and long term securities, both debt & equity, is known as capital market.

Nature of Capital Market

1. **Important component of financial market:** Capital market is an important part of financial market, which provides long-term funds.
2. **It has two segments:** Capital market has two segments i.e. primary market & secondary market.
3. **Form:** Capital markets has two form i.e. organized capital market; and unorganized capital market.
4. **Securities:** It deals in long term securities like shares, debentures, bonds, mutual funds etc.
5. **Creates dispersion in business ownership:** Capital market deals with shares of companies. So it disperses the ownership of business in many hands.
6. **Helps in capital formation:** Capital market offers opportunities to people to invest. Investment brings profits to people. They affair invested and this process continues.
7. **Utilizes intermediaries:** Capital market makes use of different intermediates such as brokers, underwriters, depositaries etc.

Primary Market

It is that market in which share & debentures and other securities are sold for the first time for collecting long term capital. This market is concerned with new issues. Therefore it is also called new issue market (NIM).

The essential function of primary market is to facilitate the transfer of investible funds from savers to entrepreneurs directly.

Methods of Raising Capital (Flotation) in New Issue Market/ Primary Market

1. **Offer through Prospectus/IPO:** It involves inviting subscriptions from the public through issue of prospectus. A prospectus makes a direct appeal to investors for raising capital through an advertisement newspaper. This is the most popular method of raising funds in primary market.
2. **Offer for Sale:** In this method a company sells securities enbloc at an agreed price to brokers, who in turn resell them to the investing public. It means company doesn't issue securities directly to the public.
3. **Private Placement:** Private placement is the allotment of securities by a company to institutional investors (UTI, LIC etc) and some selected individuals. It helps to raise capital more quickly than public issues.
4. **Right Issue (for existing company):** This is the issue of new shares to existing share holders. It is called right issue because it is the pre-emptive right of shareholders that company must offer them the new issue before subscribing to outsiders.

Under the right issue shares are offered by company to its existing shareholders at a price which is lower than the current market price and in the proportion to the number of shares they already possess.

5. **e-IPO:** A company proposing to issue capital to the public through online system of stock exchange has to enter into an agreement with the stock exchange. This is called an initial public offer (IPO). SEBI registered brokers have to be appointed for the purpose of accepting applications and placing orders.
6. **Preferential Issue:** Under preferential issue a company can make preferential allotment of its shares to its promoters at a price lower than the current market price. Such shares may be issued subject to a lock-in-period. These can't be sold in the market before the expiry of the stipulated period.

Features of Primary Market

1. **Related with new issue:** Whenever a company issues new shares or debentures, it is the activity of primary market.
2. **No particular place:** Primary market is not the activity of any particular place but the activity of bringing in new issues is called primary market.

Secondary Market

Secondary market is that market in which buying and selling of existing securities (previously issued securities) are done.

The transactions of secondary market are generally through the medium of brokers and intermediaries at a place known as stock exchange.

Features of Secondary Market

- 1. Creates liquidity:** Secondary market creates liquidity in securities by providing a platform for sale and purchase liquidity means immediate conversion of securities into cash.
- 2. It comes after primary market:** New securities are firstly sold in the primary market and thereafter it is credit in secondary market.
- 3. Particular place:** Secondary market has a particular place called stock exchange. Securities are traded, cleared and settled as per regulations of SEBI.
- 4. Encourage new investment:** The rate of shares and other securities often fluctuates in the share market. Many new investors enter into the market to exploit the available opportunities.

Difference between Primary & Secondary Market

S.No.	Basis	Primary Market	Secondary Market
1.	Issue	Securities are issued for the first time.	There is no fresh issue but trading in done in already issued securities.
2.	Buying & Selling	Investors can only buy the securities	Both buying & selling can take place.
3.	Specific Place	It has no specific place for dealing.	It has specific place for dealing called stock
4.	Price Determination	Price of securities are determined by the management of company.	Price of securities is determined by the demand & supply of securities.
5.	Sequence of trading	The trading of securities takes place first in the primary market.	A security can be traded in the secondary market only after it has already been issued in the primary market.
6.	Involvement & Investors of companies	In primary market, securities are directly issued by companies.	Securities areInterest only.
7.	Nature of companies	All companies entered in the primary market to raise capital	Only listed company's securities are bought & sold in the secondary market.

Money Market

Money Market is that market where low risk short term debt securities, which are highly liquid, are purchased and sold.

The maturity period of these securities are up to one year, so this is also called near money market.

Money market has no physical location/particular place. Most of money market transactions take place on telephone, facts or on internet only the major participants in this market are RBI, SBI and other commercial Banks, NBFC, large corporate houses etc.

Features of Money Market

1. **Meets working capital requirement of company:** Firms require short term funds for their working capital. Money Market is a major source of working capital finance.
2. **Important part of financial market:** Through money market, the short term financial needs are met. So it is an important part of financial market.
3. **More liquidity:** Because short term securities are deal in money market. So, it provides more liquidity in comparison of capital market.
4. **Low transaction cost:** Generally there is no need of brokers for the transactions done in the money market. So the transaction cost becomes slow.
5. **Forms:** Money market has two forms i.e. organized form (It includes RBI, Public sector banks, Private sector banks etc.) and unorganized market (It includes money lenders indigenous banks, chit funds, etc.)

Money Market Instruments

1. **Treasury Bills:** Treasury Bills are issued by RBI on behalf of the central govt. to meet its short term financial demands.

A treasury bill is issued in the form of promissory note of government to pay a specified sum after a specified period, which varies from 91 to 364 days.

Features:

- (i) These bills are available for a minimum amount of 25,000 in multiples thereof.
 - (ii) These are also called zero coupons bounds because they do not pay interest but the issued price is less than the redemption price.
2. **Commercial Paper:** Commercial paper is a short term unsecured, negotiable (transferable) promissory note issued by the reputed companies to meet their working capital requirements and bridge financiering. The maturity of such paper varies from 15 clays to 1 year.

It is sold at discount and redeemable at par. It can be issued in denomination of 5 lacs for multiple thereof.

★ When funds rose through commercial paper for meeting flotation costs it is called bridge financing.

3. **Call Money:** Call money is the short term finance repayable on demand with a maturity period of one day to 15 days used for inter-banking transactions. The interest rate paid on call money loans is known as the call rate. It is a highly floating rate that changes from day to day or even hour to hour....

Call money is a method by which banks borrow from each other for maintaining cash reserve ratio.

4. **Certificate of deposits (CD):** Certificates of deposits are short term unsecured, negotiable instruments in bearer form issued by commercial banks and development financial institution.

The maturity of these papers varies from 91 days to 1 year.

5. **Trade or commercial Bills:** A bill is a short term negotiable instrument containing an unconditional order signed by the markets accepted by the drawer, which directs a person to pay a specified sum of money to a particular person.

When bill is accepted by the drawer it becomes a marketable instrument and is called a trade bill.

When a trade bill is accepted by a commercial bank, it is known as commercial bill.

There maturity period is generally up to three months.

Difference between Capital & Money Market

S.No.	Basis	Capital Market	Money Market
1.	Meaning duration	It deals with long term securities with a maturity period of more than one year.	Money market instruments have the maximum tenure of one year.
2.	Instruments	The main instruments credit are equity shares, preference shared, debts. Etc.	The main instruments credit are T/Bills, commercial papers etc.
3.	Investment outlay	Security does not necessary required in huge financial outlay. The value of units of security is generally low i.e. Rs. 10, Rs.100 etc.	Transactions involving huge sums of money as instruments are quite expensive.

4.	Safety	Capital market Instruments and riskier both with respect to returns & principal repayment.	Money market is generally less riskier.
5.	Expected Return	The instruments generally yield higher returns.	The investment generally yields lesser returns.
6.	Participants	They are financial institutions, banks, public & private companies, foreign investors and general public ordinary retail investors.	All sale but foreign investors & ordinary retail investors do not participate to money market.

Stock Exchange

Stock Exchange is an institution which provides a platform for buying & selling of shares, debentures and other securities. It facilitates the exchange of securities into cash and vice-versa.

Function of Stock Exchange/Role/Importance

Stock Exchanges are integral part of an economy of any country. It performs the following functions:

- 1. Provides liquidity & market ability to existing securities:** It is the basic function of stock exchange. It provides ready market for purchase and sale of securities.
- 2. Facilitates pricing of securities:** Share prices on a stock exchange are determined by the forces of demand and supply.
- 3. Ensures safety of transactions:** In stock market, only listed securities are traded. Listed companies and members of stock exchanges have to operate within the strict rules and legal frame work. This ensures safety of dealings through stock exchanges.
- 4. Contribute the economic growth:** It is a market in which existing securities are credit, which helps in channelizing the savings into productive means. This leads to capital formation and economic growth.
- 5. Spreading the equity cult/market:** It plays an important role in ensuring wider share ownership by regulating new issues, better trade practices and taking effective steps in educating the public about investment.
- 6. Provide scope for speculation:** It provides sufficient scope within the provision of law for speculating activities in a restrictive and controlled manner.

Trading producer on a Stock Exchange

1. **Selection of broker:** The first step in to select the broker on behalf of investor. Brokers are the registered members of stock exchange through whom trading of securities is done. Broker may be an individual, a partnership firm or the company.
2. **Placing the order:** The investors specify the number & types of securities that he wants to purchase & sell.
3. **Executing the order:** According to the instruction of investors the broker buys and sells the securities.
4. **Settlement:** Transactions on a stock exchange may be carried out on either cash basic or a carryover basis i.e. forward settlement. The carryover basis or forward settlement is also called BADLA in Indian stock exchange. The stock exchange here is divided into periods called "account", which varies from forth night to a month. Transactions can be carried forward for an account for settlement of transaction during one account. There is electronic book entry for transfer of share certificates and money through demat account.

SEBI Securities & Exchange Board of India

The SEBI was established by central government through an act known as Securities and Exchange Board of India Act, 1992.

The SEBI has assumed the status of an umbrella, watch dog over the electronic financial service sector in India. Its head office is in Mumbai and its regional offices are situated in Kolkata, Chennai and Delhi.

Objectives Purpose of SEBI

The overall objective of SEBI is to protect the interest of investors and to promote the development of security market. This is explained as follows:-

- (i) To regulate stock exchanges and security industry to promote their orderly functioning.
- (ii) To safeguard the interest of investors by minimizing the price manipulations, fraudulent practices and by educating the investors.
- (iii) To promote the development of security market by making its functioning efficient and transparent.
- (iv) To regulate and develop a code of conduct and fair practices by intermediates like brokers, with a view to make them competitive & professional.

Functions of SEBI

(A) Regulatory Functions

These functions are performed by SEBI to regulate the business in stock exchange. These are:

- (i) Registration of brokers, sub-brokers and other players in the market.
- (ii) Registration of corrective investment schemes & mutual funds.

- (iii) Registration of stock brokers, port folio exchanges, merchant bankers and underwriters.
- (iv) SEBI has framed a code of conduct to regulate the intermediaries.
- (v) Conducting inquiries & audits of stock exchanges & intermediaries.
- (vi) Levying Fee and other changes on intermediaries

(B) Development Functions

These functions are performed by the SEBI to promote and develop the activities in Stock Exchange.

These are:

- (i) Providing training to intermediaries.
- (ii) Conducting research and publishing information to all market participants.
- (iii) Providing education to investors.
- (iv) Promotion of fair trade practices & code of conduct.

(C) Protective Functions

These functions are performed by the SEBI to protect the interest of investors. These are:

- (i) SEBI prohibits fraudulent and unfair trade practices in securities market.
- (ii) SEBI prohibits insiders trading & imposes penalties for such practices.

An insider is any person connected with the company, who is having price sensitive information regarding securities of companies which is not available to general public for example:-Directors, managers, Promoters etc.

- (iii) Undertaking steps to educate the investors.
- (iv) To promote fair trade practices & code of conduct in securities market.

Question Answers

Q 1. A bank named 'Dhan Sangraha Karta' allows Kapoor family to deposit their money . It gives a definite return to this family which is in the form of interest. To get this interest the money stored in the household of Kapoor family gets entry into this bank. Nearby there is a stock exchange, Mr. Rajan Kapoor, who is the head of the family, goes there and buys securities. He says that in this way more return is earned by him on his saved money though the risk is also there.

1. Identify the process in above case performed by the bank and the stock exchange.
2. What are the roles of the bank and the stock exchange with respect to each other?
3. Name a condition for the bank to perform its role in this process.
4. Name a condition for the stock market to perform its role in this process.

Answer:

1. The process performed by the bank and the stock exchange is 'Financial Intermediation.
2. The bank and the stock exchange are competing intermediaries in the financial system. The household is making a choice between the bank and the stock exchange and this choice is given by the financial system to them.
3. The bank should provide a higher rate of return to the household saving then what it would get by lying passive in the household itself. Since the money will only decrease in value there will be no return.
4. The stock exchange will help the household invest money in a company's security. The chances of growth of money could be highest here as the money is generally invested in companies which show the chances of the best possible growth.

Q 2. These days, the development of a country is also judged by its system of transferring finance from the sector where it is in surplus to the sector where it is needed the most. To give strength to the economy, SEBI is undertaking measures to develop the capital market. In addition to this, there is another market in which unsecured and short-term debt instruments are actively traded every day. These markets together help the savers and investors in directing the available funds into their most productive investment opportunity.

1. Name the function being performed by the market in the above case.
2. Name the market segment other than the capital market segment in which unsecured and short-term debt instruments are traded.

Answer:

1. Allocative function.
2. Money market.

Q 3. A company uses a financial instrument for bridge financing. The instrument here is short term, low risk, unsecured and highly liquid. It needed to buy machinery for which it issued equity. This turned out to be expensive as this issue involved floatation costs. The company is a large and creditworthy and this method has come up as a great help to it.

1. Which financial instrument is indicated in the above case?
2. Which type of instrument is this?
3. Name the types of floatation costs which are generally involved?
4. How has this method helped the company?
5. Name two money market instruments which are issued at discount and redeemed at Par.

Answer:

1. The financial instrument indicated in the above case is 'Commercial Paper'.
2. This is a money market instrument.

3. The types of floatation costs involved here are:

- o Brokerage.
- o Publishing costs.
- o Advertising costs.
- o Underwriter's commission.

4. This method has helped the company by providing short-term funds for its seasonal and working capital needs.

5. The two money market instruments which are issued at discount and redeemed at par are:

- o Treasury bill
- o Commercial paper.

Q 4. 'Dhan Samudra' is a bank, which needs immediate cash. This has been the situation since the RBI chose to increase the CRR (Cash Reserve Ratio). It is looking for other banks to meet its cash requirements by borrowing from other banks in the industry. However, it resorts to a very expensive source of fund. This source of fund has an inverse relationship with other sources of funds like commercial paper and certificates of deposit.

1. Which financial instrument is highlighted In the above case?
2. How does increased CRR change the cash requirements by banks?
3. Why this financial instrument considered an expensive source of finance?
4. What type of inverse relationship exists between this instrument and commercial paper or certificates of deposit?

Answer:

1. The financial instrument highlighted in the above case is 'Call Money'.
2. The increase in CRR (Cash Reserve Ratio) makes a bank keep a definite amount of cash. For example, if CRR is 5% then bank will have to keep 5% of its money as the cash reserve which it will not touch. Thus the ability of the bank to give loans is reduced thus reducing liquidity in the market.
3. Call Money is considered an expensive source of finance because it is made available to the banks at a very short notice. The interest paid by the banks seeking call money is call rate. The call rate is highly volatile and changes on an hourly basis.
4. The inverse relationship which exists between call money and these instruments is that with the rise in the call money rates these sources become cheaper. So the banks have the option of raising funds from these sources in a comparatively cheaper manner.

Q 5. Ramesh the CEO of a company thinks of going with the most popular method of raising funds used by the public companies. He discussed this option with his immediate subordinates. After discussion he

realises that since his company is a private company he should think of some other option. Then they think of issuing the securities through intermediaries like issuing houses or stock brokers. When his nephew comes to know about his decision, he decides to suggest his uncle another way. He advises him to involve institutional investors which will help him raise funds more quickly and reduce many mandatory and non-mandatory expenses. After a lot of discussion the option suggested by his nephew is chosen as final.

1. In the above case identify the various methods of floatation highlighted.
2. Which method do you think will be applicable in the primary market?
3. In which type of capital market trading of only existing shares is done?
4. In which type of capital market only buying of securities is possible as securities can't be sold here?
5. Which type of capital market doesn't have fixed geographical location?

Answer:

1. The various methods of floatation highlighted in the above case are:
 - o Offer through prospectus. Ramesh the CEO of a company thinks of going with the most popular method of raising funds used by the public companies.
 - o Offer for sale. Then they think of issuing the securities through intermediaries like issuing houses or stock brokers.
 - o Private placement. He advises him to involve institutional investors which will help him raise funds more quickly and many mandatory and non-mandatory expenses could be avoided.
2. The method which will be applicable in the primary market will be 'offer through prospectus'.
3. The type of capital market in which trading of only existing share is done is 'Secondary Market (Stock Exchange)'.
4. Primary Market
5. Primary Market

Q 6. Raman who is a broker in a stock exchange has to face challenging questions from society. His own family sometimes asks him to think about his decision to become a broker. He however, has full faith in the stock exchange. He knows that the membership of a stock exchange is properly regulated abiding the legal system and the public doing investment is safe in making deals. His children one day asked him the reason behind the ups and downs in the stock market. He clarified their doubt by telling them that forces of supply and demand decide the prices of securities in the secondary market. Off late he has decided to write a book on the functioning of stock exchange and its significance in the Indian economy. He is trying to highlight in his book how through the process of investment and disinvestment existing

securities are sold and resold and savings are channelized into the most productive opportunities.

Definitely Raman is justifying his presence in his job.

1. What is the meaning of Stock Exchange?
2. Identify and briefly explain the functions of Stock Exchange discussed in the above case.
3. What is an e-IPO?

Answer:

1. Stock exchange is a collection of individuals, formed as a body or not, constituted for the objective of helping, controlling and regulating the dealings related to buying and selling of securities.
2. The different functions of Stock Exchange highlighted in the above case are:
 - o Ensures safety of transaction. He knows that the membership of a stock exchange is properly regulated abiding the legal system and the public doing investment is safe in making deals.
 - o Helps in deciding pricing of securities. He clarified their doubt by telling them that forces of supply and demand decide the prices of securities in the secondary market.
 - o Helps in contributing to the economic growth. He is trying to highlight in his book how through the process of investment and disinvestment existing securities are sold and resold and savings are channelized into the most productive opportunities.
3. When a company proposes to issue capital to the public with the help of on-line system of the stock exchange and enters into an agreement with it. This method of issuing of capital to the public is known as e-IPOs.

Q 7. Ashish selects a person who is authenticated to buy or sell securities on his behalf. He is registered by SEBI. Then through this person Ashish opens an account with a bank. Then he takes the next step. He gives this person an order in which he specifies the number and types of securities to be bought or sold. The process moves forward. After getting the instructions from Ashish the selected person buys and issues d' paper. The paper contains the name and price of securities, brokerage charges and the name of the parties involved. Then comes the concluding stage of the process. Here, the trading of securities is done by the selected persons on behalf of Ashish.

1. Identify the process highlighted in the above case.
2. Which type of account is being indicated here?
3. What is the role of bank here?
4. What is the role of the person he has chosen?

5. What one condition should be met when giving orders for the purchase of securities?
6. What is the name of the paper highlighted above?
7. What is the last stage of the process called? Does it have any specific feature?

Answer:

1. The process highlighted in the above case is 'Trading procedure on a Stock Exchange'.
2. The type of account indicated here is 'Demat Account'.
3. The bank is the 'Depository Participant'.
4. The person chosen here is the 'Broker'.
5. The condition which must be met is that the securities traded should be of the listed companies.
6. The name of the paper which is highlighted above is 'Contract Note'.
7. The last stage of the process is called 'Settlement'. The specific feature is the T+2 rolling settlement feature. It means that the trading of security taking place on a particular day will get settled after two days. For example trading taking place on Wednesday will be settled by Friday.

Q 8. Identify the type of function of SEBI in the following cases:

1. Rajeev was unwilling to buy shares in the stock market as he was told by someone that stock market is a place where various malpractices take place. He decides to discuss the matter with his friend who explains to him how SEBI takes care of the interests of the investors.
2. Pankaj wants to become a stock broker. When he approaches people and asks them to get started as investor through him they ask for a certificate which the SEBI must have given him. He becomes aware of the fact that in order to function as a stock broker he will have to get registered with SEBI.
3. Kirti Steels already has issued shares in the stock market and is a well known name among the people. Recently it issued shares but had to go through the proper audition process and thorough inspection about the various requirements to be fulfilled as an issuer.
4. Recently some people were caught in some of the malpractices like insider trading. The SEBI has decided to take strict action and cancel their candidature. Further penalties are also to be imposed on them.

Answer:

1. Protective function
2. Regulatory function
3. Regulatory function
4. Protective function

Q 9. A company wanted to raise funds so it reached out to facilities an institutional arrangements through which long term funds (debt + equity) were raised and invested. A lot of thinking was done whether the company should have gone for debt or equity. Finally, it decided to go for equity. The owner of the company decided to follow the guidelines of SEBI.

1. Which concept of financial market is highlighted in the starting of the case?
2. Name two objectives of SEBI.

Answer:

1. The concept of financial market which is highlighted in the above case is 'Capital Market'. A company wanted to raise funds so it reached out to facilities and institutional arrangements through which long term funds (debt + equity) were raised and invested,
2. The two objectives of SEBI are:
 - o SEBI regulates the security industry and the stock exchanges. It ensures their proper functioning.
 - o SEBI ensures investors' protection by taking various steps against malpractices in stock market

Q 10. Rajni Auto manufacturers have decided to give a special privilege to the existing shareholders to subscribe to the new issue of shares where they will be given shares according to the proportion of shares held by them. The company always gives special treatment to loyal stakeholders. Last year the company was dealing through the capital market where both the buying and selling of securities were taking place. The owner of the company is a man of ethical business. He recently wrote an article about the watchdog of stock market. The article gained a lot of popularity and now is part of the curriculum of MBA students.

1. Which method of floatation was used by Rajni Auto manufacturers?
2. Which type of capital market was this company dealing in?
3. Which watchdog of the capital market has been referred to in the above case?
4. Name two regulatory functions of this above referred organisation?

Answer:

The method of floatation used by the company is 'Rights Issue'. Rajni Auto manufacturers have decided to give a special privilege to the existing shareholders to subscribe to the new issue of shares where they will be given shares according to the proportion of shares held by them.

1. The company was dealing with the 'Secondary Market'.
2. Last year the company was dealing through the capital market where both the buying and the selling of securities were taking place.

3. The watchdog of the stock market referred to in the above case is 'SEBI' (Securities and Exchange Board of India).
4. The two regulatory functions of SEBI are:
 - o SEBI regulates registration of brokers and sub-brokers in the market.
 - o SEBI does the regulation of takeover bids by different companies.

SHORT ANSWER QUESTION

Q 11. Meca Ltd. a reputed automobile manufacturer needs Rupees ten crore as additional capital to expand its business. Atul Jaian, the CEO of the company wanted to raise funds through equity. On the other hand the Finance Manager, Nimi Sachdev said that the public issue may be expensive on account of various mandatory and non-mandatory expenses. Therefore, it was decided to allot the securities to institutional investors.

Name and explain the method through which the company decided to raise additional capital

Answer:

Private Placement

Q.42 Give the meaning of the following money market instruments

(i) Certificate of deposit; and

(ii) Commercial bill

Ans. (i) Certificate of deposit These are short-term, unsecured, negotiable instruments in bearer form. They are issued by commercial banks or development financial institution to individuals, corporations and companies. These are issued generally in times of tight liquidity when the deposit growth of banks is slow but the demand for credit is high, to mobilise large amounts of money for short periods.

(ii) Commercial bill A commercial bill is a bill of exchange used to finance the working capital requirements of business firms. It is a short-term negotiable, self liquidating instrument, which is used to finance the credit sale of the firms. When goods are sold on credit, seller draws the bill of exchange on the buyer. On being accepted by the buyer, it becomes a trade bill, which is a marketable instrument. On being discounted from the bank, the trade bill becomes the commercial bill.

Q.43 Financial market plays an important role in the allocation of scarce resources in an economy by performing various functions. Explain any three functions of financial market.

Ans. Financial market plays an important role in the allocation of scarce resources in an economy by performing these important functions:

(i) Mobilisation of savings and channeling them into the most productive uses A financial market facilitates the transfer of savings from savers to investors. Thus, it will help in channelising surplus funds into the most productive uses.

(ii) Facilitating price discovery Interaction between supplier and investor helps to establish a price for the

financial asset which is being traded in that market.

(iii) **Providing liquidity to financial assets** Financial market facilitates easy purchase and sales of financial assets. In doing so, they provide liquidity which means these assets are converted into cash whenever required

Q.44 What is meant by primary market? Explain any two methods of floating new issues in the primary market

Ans. Primary market is the market where securities are being issued for the first time. Therefore, it is also known as 'New Issue Market' (NIM).

Methods of floatation are as follows:

(i) **Offer through prospectus** Under this method, company issues a prospectus to inform and attract general public. In prospectus, company provides details about the purpose for which funds are being raised, past financial performance of the company, background and future prospects of company.

(ii) **e-IPOs** It is the new method of issuing securities through online system of stock exchange. In this, company has to appoint registered brokers for the purpose of accepting applications and placing orders. The issuer company has to apply for listing of its securities and the leading manager coordinates all the activities of these issues through various intermediaries

Q.45 Nature of a capital market can be well explained with the help of its features. State any three such features of a capital market.

Ans. The features of a capital market are: (Any three)

(i) **Link between savings and investment opportunities** Capital market is a crucial link between saving and investment process. The capital market transfers money from savers to entrepreneurial borrowers.

(ii) **Long-term funds** Capital market is concerned with medium-term and long-term funds. Funds raised through capital market are used for long-term financial needs such as procuring plant, machinery, land, etc.

(iii) **Participants** Both individual investors and institutional investors participate in capital market.

(iv) **Instruments** The main instruments of a capital market are equity shares, preference shares, bonds and debentures

LONG ANSWER QUESTIONS

Q.46 Financial market plays an important role in the allocation of scarce resources in an economy by performing many important functions. Explain any four such functions

Ans. **Meaning of financial market** It is a link between the savers and the borrowers. This market transfers money or capital from those who have surplus money to those who are in need of money.

The functions of financial market are:

(i) **Facilitating price discovery** In the financial market, households are suppliers of funds and business firms represent the demand. The interaction between them helps to establish a price for the financial asset which is being traded in that particular market.

(ii) **Provides liquidity to financial assets** The investors can invest their money, wherever they desire, in securities through the medium of financial market and convert them into cash by selling their financial assets through the mechanism of financial market.

(iii) **Reduce the cost of transactions** Financial market provides complete information regarding price, availability and cost of various financial securities. So, investors and companies do not have to spend much on getting this information.

(iv) **Mobilisation of savings and channelising them into most productive uses** A financial market facilitates the transfer of savings from savers to investors. It gives savers a wide choice of making investments and thus, channelise surplus funds into productive uses

Q.47 Explain the following money market instruments (Delhi 2013)

(i) Call money (ii) Treasury bill

(iii) Commercial paper (iv) Certificate of deposit

Ans. Money market refers to market for short-term funds, which deals in monetary assets whose period of maturity is upto one year.

(i) **Call money** It is a method by which commercial banks borrow from each other. It is short-term finance repayable on demand, with a maturity period of one day to fifteen days, used for inter-bank transactions.

(ii) **Treasury bill (T-bill)** It is an instrument of short-term borrowing by the RBI on behalf of government of India, maturing in less than one year. They are also known as zero coupon bonds. They are issued in the form of promissory note. They are highly liquid and provide assured yield. There is no risk of default. They are issued at a discount and repayable at par. They are available for a minimum amount of ₹ 25,000 and in multiples thereof.

(iii) **Commercial Paper (CP)** A commercial paper is an unsecured instrument issued in the form of a promissory note. They are negotiable and transferable by endorsement and delivery. It is issued by large and credit worthy companies for reusing short-term funds at lower rates of interest than market rates. It usually has a maturity period of 15 days to one year. It is sold at a discount and redeemed at par.

(iv) **Certificate of Deposit (CD)** They are unsecured, negotiable, short-term instruments in bearer form, issued by commercial banks. Only bank can issue CD. It is a bearer certificate and is negotiable in the market

Q.48 Explain any four methods of floating new issues in the primary market.

Ans. There are various methods of floating new issues in the primary market: (Any four)

(i) **Offer through prospectus** Under this method, company issues a prospectus to inform and attract general public. In prospectus, company provides details about the purpose for which funds are being raised, past financial performance of the company, background and future prospects of company.

(ii) **Offer for sale** Under this method, securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers at a fixed price.

(iii) **Private placement** Under this method, company sells the securities to some selected institutional investors (like UTI, LIC, etc) and some individuals.

(iv) **e-IPOs** It is the new method of issuing securities through online system of stock exchange. In this, company has to appoint registered brokers for the purpose of accepting applications and placing orders.

(v) **Right issue** This is a right (or privilege) to existing shareholders to subscribe to a new issue of shares in proportion to the number of shares held by them

Q.49 Explain any four functions of "Stock Exchange."

Ans: The term "stock exchange" refers to a market where existing securities are bought and sold. The major functions of a stock exchange are as follows.

a. **Provides Liquidity and Marketability:** Stock exchange provides a ready platform for trading of existing securities. To put it another way, it acts as a continuous market for the sale and acquisition of securities. Securities can be easily turned into cash at any time through the stock exchange. Long-term securities can also be changed into medium-term and short-term securities via the stock exchange.

a. **Price Determination:** A stock exchange assists in determining the price of monetary assets traded in the market. It provides a platform for buyers and sellers of securities to communicate, assisting in the determination of security prices through the forces of supply and demand.

b. **Aids Economic Growth:** Securities are constantly bought and exchanged on a Stock Exchange. This continual cycle of disinvestment and reinvestment aids in directing savings and investments to the most profitable uses possible. This boosts capital formation and economic growth as well.

c. **Speculation Capacity:** It is widely assumed that some level of speculation is required for improved liquidity and to keep demand and supply of securities in balance. Within the confines of the law, the stock exchange allows for a reasonable and limited amount of speculation

Q.50 Explain the objectives and functions of the SEBI

Ans: The Securities and Exchange Board of India (SEBI) was founded in 1988 to promote the orderly and healthy expansion of India's securities market. SEBI was set with an investor protection as the overarching goal, as well as the development and regulation of securities market functions.

SEBI's objectives are as follows:

SEBI's overall goal is to protect investors' interests while also promoting the development and regulation of the securities industry. This may be elaborated as follows:

- a. Promotion: To promote the orderly operation of stock exchanges and the securities industry by regulating them.
- a. Security: Protecting the rights and interests of investors, especially individual investors, as well as guiding and educating them. To prevent trading malpractices and strike a balance between the securities industry's self-regulation and legislative control.
- b. Rules and regulations: To regulate and develop a code of conduct and fair procedures for intermediaries such as brokers, merchant bankers, and other financial intermediaries in order to make them more competitive and professional.

Functions of SEBI:

SEBI was charged with the dual responsibility of both regulation and growth of the securities market in India, due to the emerging nature of the securities sector.

- Regulatory Functions

SEBI performs the following regulatory functions:

- a. All market participants, including brokers, sub brokers, and other market participants, must register.
- a. Collective investment plans and mutual funds must be registered.
- b. Stock bankers, portfolio exchanges, and merchant bankers are all regulated.
- c. Business practices that are dishonest or unfair are prohibited.
- d. Regulating insider trading and hostile takeover bids, as well as enforcing penalties for such conduct.
- e. Imposing a fee or other charge in order to carry out the Act's purposes.
- f. Executing and exercising such powers as the Government of India may designate under the Securities Contracts (Regulation) Act 1956.

- Development Functions:

- a. Investor education: Investor education is concerned with concerns of the education and information needs of people who participate in, or are considering participating in, the financial markets. Investor education can also assist investors in determining the relevance and acceptability of investing advice.
- a. Training of intermediaries: It facilitates the training of intermediaries and attempts to promote stock exchange activity through an adaptable and flexible approach.
- b. Fair practices and a code of behavior for all SROs are promoted: A self-regulatory organization (SRO), such as a non-governmental organization, has the authority to develop and implement independent industry and professional regulations and standards.
- c. Research: Conducting research and disseminating data that will benefit all market players

CHAPTER - CONSUMER PROTECTION

LEARNING OUTCOMES:

- Understand the concept of consumer protection.
- Understand the concept of a consumer according to the Consumer Protection Act, 2019.
- Explain the consumer rights
- Understand the responsibilities of consumers
- Understand who can file a complaint and against whom?
- Discuss the legal redressal machinery under Consumer Protection Act, 2019.
- Examine the remedies available to the consumer under Consumer Protection Act, 2019

The new Consumer Protection Act, 2019 came into force on 20th July 2020 and it will empower consumers and help them in protecting their rights through its various notified rules and provisions.

The new act will be swift and less time consuming compared to the older Consumer Protection Act, 1986 in which single-point access to justice was given making it a time-consuming exercise.

The old act provided for a three-tier consumer dispute redressal machinery at the National (National Consumer Disputes Redressal Commission), State and District levels.

Meaning of Consumer Protection:

Consumer protection refers to protecting the consumer against anti-consumer trade practices by the producers or sellers.

Who is a 'Consumer' under the Consumer Protection Act 2019 ?

As per Section 2(7) of the 2019 Act, consumer is any person who buys goods or avails any service for a consideration and includes any user except for the person who has availed such services or goods for the purpose of resale or commercial use. The explanation to the definition specifically states that the expression "buys any goods" and "hires or avails any services" includes all online transactions conducted through electronic means or direct selling or teleshopping or multi-level marketing. Online transactions is an exclusive feature of this act and added keeping in mind the growing e-commerce business and advancement in technology.

"consumer" means any person who—

- (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or
- (ii) hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such service other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person, but does not include a person who avails of such service for any commercial purpose.

Explanation.—For the purposes of this clause,—

- (a) the expression "commercial purpose" does not include use by a person of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment;
- (b) the expressions "buys any goods" and "hires or avails any services" includes offline or online transactions through electronic means or by teleshopping or direct selling or multi-level marketing;

CONSUMER RIGHTS AS PER CONSUMER PROTECTION ACT 2019:

"consumer rights" includes,—

- (i) the right to be protected against the marketing of goods, products or services which are hazardous to life and property;
- (ii) the right to be informed about the quality, quantity, potency, purity, standard and price of goods, products or services, as the case may be, so as to protect the consumer against unfair trade practices;
- (iii) the right to be assured, wherever possible, access to a variety of goods, products or services at competitive prices;
- (iv) the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate fora;
- (v) the right to seek redressal against unfair trade practice or restrictive trade practices or unscrupulous exploitation of consumers; and
- (vi) the right to consumer awareness;

A COMPLAINANT AS PER CONSUMER PROTECTION ACT 2019:

"complainant" means—

- (i) a consumer; or
- (ii) any voluntary consumer association registered under any law for the time being in force; or
- (iii) the Central Government or any State Government; or
- (iv) the Central Authority; or
- (v) one or more consumers, where there are numerous consumers having the same interest; or
- (vi) in case of death of a consumer, his legal heir or legal representative; or
- (vii) in case of a consumer being a minor, his parent or legal guardian;

Establishment of Central Consumer Protection Authority:

The Consumer Protection Act, 2019 establishes the Central Consumer Protection Authority (CCPA) whose primary objective will be to promote, protect and enforce the rights of consumers. It is empowered to:

- Conduct investigations into violations of consumer rights and institute complaints/prosecution.

- Order recall of unsafe goods and services. Order discontinuance of unfair trade practices and misleading advertisements.
- Impose penalties on manufacturers/endorsers/publishers of misleading advertisements.

The Central Government will appoint the members of the CCPA. The authority will consist of a Chief Commissioner along with other such prescribed members.

The 2019 Act specifies the functions of the CCPA and who will appoint its members. However, there is ambiguity as to how the CCPA will perform its functions and what methods will it adopt to achieve its functions. There is also no specification of qualification for the recruitment of the members of the CCPA. Further, the appointment of members of the CCPA by the Central Government will affect the independence of the authority. The consumer may be at a disadvantage in a dispute where the government has provided deficient services.

Consumer Dispute Redressal Forums

Jurisdiction

1. Territorial Jurisdiction: A complainant can now file a complaint where he resides or works. The repealed Act only allowed the complainant to file a complaint where the opposite party carries out business or resides. This caused a lot of difficulties to the complainants.
2. Pecuniary Jurisdiction: The pecuniary jurisdiction will now be determined on the basis of the consideration paid for the value of goods purchased and services availed, rather than the compensation claimed as per the repealed Act of 1986.

The pecuniary jurisdiction limit has also been increased for the various commissions under the 2019 Act.

DISTRICT COMMISSION:

The District Commission will now deal with cases of up to Rs. 1 Crore, up from Rs. 20 lakhs as per the repealed Act.

Each district commission shall consist of a President and not less than 2 and not more than such number of members as may be prescribed in consultation with the central government.

Any person aggrieved by an order made by the district commission may prefer an appeal against such order to the state commission on the grounds of facts or law within a period of 45 days from the date of the order in such form and manner as may be prescribed.

STATE COMMISSION:

The State Commission's pecuniary jurisdiction limit has been fixed between Rs. 1 Crore to Rs. 10 Crores.

State commission shall consist of a President and not less than 4 or not more than such number of members as may be prescribed in consultation with the central government.

Any person aggrieved by an order made by the state commission in exercise of its powers may prefer an appeal against such order to the National commission within a period of 30 days from the date of the order in such form and manner as may be prescribed.

NATIONAL COMMISSION:

National Commission will deal with cases with pecuniary limit of Rs. 10 Crores or more.

The National commission shall consist of a President and not less than four and not more than such number of members as may be prescribed. Provided further that no president or members shall hold office as such after he has attained such age as specified in the rules made by the central government which shall not exceed :-

- (a) in the case of the president the age of 70 years ;
- (b) in the case of any other member the age of 67 years.

Any person aggrieved by an order made by the National commission in exercise of its power may prefer an appeal against such order to the supreme court within a period of 30 days from the date of the order.

CONSUMER RESPONSIBILITIES AS PER CONSUMER PROTECTION ACT 2019:

1. Consumers must exercise their rights: They must be aware of their rights while buying.
2. Consumers should buy only standard goods like ISI/AGMARK goods only.
3. Filing complaint for the redressal of genuine grievances.
4. Consumers must be quality conscious / should not compromise on quality.
5. Consumers Should learn the risks associated with products and services.
6. Do not forget to get a receipt and Guarantee / Warranty Card.
7. Consumers should read labels carefully.
8. Consumers should be honest in their dealings. They should buy only legal goods.
9. Consumers should respect the environment. Avoid waste, littering and contributing to pollution.
10. Consumers should form consumer societies.

REMEDIES AVAILABLE IN CONSUMER PROTECTION ACT 2019:

(a) Removal of Defects:

If after proper testing the product proves to be defective, then the 'remove its defects' order can be passed by the authority concerned.

(b) Replacement of Goods:

Orders can be passed to replace the defective product by a new non-defective product of the same type.

(c) Refund of Price:

Orders can be passed to refund the price paid by the complainant for the product.

(d) Award of Compensation:

If because of the negligence of the seller a consumer suffers physical or any other loss, then compensation for that loss can be demanded for.

(e) Removal of Deficiency in Service:

If there is any deficiency in delivery of service, then orders can be passed to remove that deficiency. For instance, if an insurance company makes unnecessary delay in giving final touch to the claim, then under this Act orders can be passed to immediately finalise the claim.

(f) Discontinuance of Unfair/Restrictive Trade Practice:

If a complaint is filed against unfair/restrictive trade practice, then under the Act that practice can be banned with immediate effect. For instance, if a gas company makes it compulsory for a consumer to buy a gas stove with the gas connection, then this type of restrictive trade practice can be checked with immediate effect.

(g) Stopping the Sale of Hazardous Goods:

Products which can prove hazardous for life, their sale can be stopped.

(h) Withdrawal of Hazardous Goods from the Market:

On seeing the serious adverse effects of hazardous goods on the consumers, such goods can be withdrawn from the market. The objective of doing so that such products should not be offered for sale.

(i) Payment of Adequate Cost:

In the end, there is a provision in this Act that the trader should pay adequate cost to the victim concerned.

✓ Points to Remember:-

1. Consumer protection is important because business exists to satisfy human needs, businessmen are trustees of wealth, consumers have legal rights, redressal and education, and a healthy environment.
2. Consumers also have responsibilities.
3. Consumer organizations and NGOS can play a vital role for consumer protection.

SHORT AND LONG ANSWER TYPE QUESTIONS:

Q1) Which consumer right gives the business firms freedom to set up their own consumer service and grievance cells?

Ans: Right to representation.

Q2) Mention when as a consumer you are not in a position to resolve your grievance under consumer protection act.

Ans: As a consumer we are not in a position to resolve our grievances when we have not fulfilled the responsibilities of a consumer.

Q3) Sandeep purchased a diesel car for Rs. 77 lacs from an automobile company and found its engine defective. Despite many complaints the defect was not rectified. Suggest to him the appropriate authority where he could file a complaint under consumer protection Act.

Ans: District Forum.

Q4) A co. is using sub-standard electric wiring in its coolers. Which consumer right is being violated?

Ans: Right to safety.

Q5) Which document serves as evidence of purchase?

Ans) "Cash Memo."

Q6) Rita wants to buy a packet of juice. As an aware customer, how can she be sure about the quality of juice she plans to buy?

Ans: Rita can check for FPO (Fruit product order 1955) certifications. She can check the date of manufacture and expiry and check the storage / display conditions.

Q7) Mr. Sanjay a consumer purchased medicines without noticing the date of expiry. He also did not obtain the cash memo. Do you think he will be able to protect himself by the loss caused due to expired medicines? Give reasons in support of your answer?

An) In the given case, Mr. Sanjay as a consumer was not able to fulfill his Responsibility on two fronts.

(I) He didn't go through the packing specifications mentioned on the product at the time of purchase.

(II) Most importantly, he did not obtain the cash memo from the surer. A Cash memo is a proof of purchase and it is a must for filing any complaint. Hence, he will not be able to protect himself by the loss caused due to expired medicines.

Q8) Mr. Verma, who was a vegetarian, went to a snack bar for having French fries and later found out that it had non-vegetarian content. Neither the advertisement nor the packaging of the product displayed that the product has non-vegetarian content. Will Mr. Verma be able to claim compensation which right of the consumer is violated here?

Ans: In the given case there is violation of the consumer right to know. Acc. to the amendment of the regulations in weight and measurement Act.(2000) every product should explicitly bear a green dot for vegetarian ingredients while brown reveals that non-vegetarian ingredients have been used. It is also mandatory to show the dot on advertisements electronic or press and all posters, banners, stunts etc. hence Mr. Bharti would be able to claim the compensation.

Q9) As a well informed consumer what kind of quality certification marks will you look for before buying 'products'?

Ans) Some of the quality certification marks are:

(1) FPO(Fruit Products Order 1955) – It contains specification and quality control requirements regarding the production and marketing of processed fruits and vegetables, sweetened aerated water, vinegar and synthetic syrups.

(2) ISI- On consumer durable products.

(3) Hallmark- BIS certification scheme for gold jewellery items.

(4) Earthen Pitcher –For Labeling Environment friendly products.

(5) AGMARK – It is a grade standard for agricultural commodities and like Stock products.

(6) Wool mark- It signifies 100% pure wool.

Q10) A shopkeeper sold you some spices, claiming that they were pure. Later a laboratory test concluded that those were adulterated. What precautions should you have taken before buying and what remedies are available to you for the wrong act?

Ans) We should have been conscious about quality and should obtain cash memo from the seller while purchasing goods. The remedies available are:

(1) Getting the product replaced

(2) Getting the refund of the price

(3) Compensation.

Q11) What is the quality mark provided to agricultural commodities and livestock products?

Ans: AGMARK.

Q12) Saroj wants to file a complaint where the value of goods or services in question along with the compensation claimed amounts to ₹3 Crore.

Ans) State Commission.

Q13) What is meant by the right to be heard to a consumer?

Answer: Nowadays, with the emphasis on Marketing Concept, almost all the business houses have their consumer grievance cell where the complaints of the consumers can be heard and the consumers can seek justice for their exploitation by the goods or service providers. This is called Right to be heard.

Q14) Which claims can be appealable before the Supreme Court under Consumer Protection Act?

Answer: It takes appeals against Orders passed by the State National commission which have a value of more than 10 crore rupees.

Q15) Which consumer right entitles the consumer to get relief in case the product or service falls short of his expectations?

Answer: Right to Seek Redressal.

Q16) Sirajuddin purchased a car for ₹95 lacs from an automobile company and found that its airbags were defective. After many complaints with the company that went unheard, he filed a case in the District Forum. He was not satisfied with the orders of the District Forum. He then appealed before the State Commission and, being dissatisfied with the orders of the State Commission, he appealed before the National Commission. Sirajuddin was not satisfied with the orders of the National Commission. Suggest him the highest authority where he could appeal against the decision of the National Commission.

Answer: Sirajuddin cannot appeal to any other higher authority. This is because only those matters which have been directly filed in the National Commission and where the value of goods and services in question along with the compensation claimed exceed ₹10 crore are appealable before Supreme Court. Their main function centers on maintaining the trade practices that are offered by the seller to the consumers. Consumers are free to file a case against the seller if they have been exploited or harassed which in this Sirajuddin has been done.

Q17) Jolly bought an Anti-dandruff Shampoo of a reputed company which claimed to contain zinc pyrithione (ZPTO) to control dandruff. When the product did not show the promised results even after regular use for two months she discussed the problem with his aunt Dolly who is a dermatologist. Dolly told him ZPTO is an antifungal agent, meaning that only dandruff caused by a fungal infection could be 'cured.' But to Jolly's surprise, this condition was not mentioned in the shampoo case.

In the context of the above case:

a) Identify and explain the consumer right being violated in the above case.

b) List any two other consumer rights.

Answer: a) Right to information is being violated in the above case.

The Consumer Protection Act, 2019 protects the interests of the consumers in the widest range possible. According to the Right to information, the consumer has the right to get complete information about the product that he/she may propose to buy including its contents, date of manufacture and expiry, maximum retail price, quantity, directions for use etc. Moreover, as per law, it is mandatory for marketers to provide complete information about the product/service to buyers.

b) The two other consumer rights are:

Right to be Heard

Right to Seek Redressal.

Q18) Prakhar purchased an ISI mark electric iron from 'Bharat Electricals'. While using it he found that it was not working properly. He approached the seller and complained about the same. The seller satisfies Prakhar by saying that he will ask the manufacturer to replace this iron. The manufacturer refused to replace it and Bharat Electricals decided to file a complaint in the consumer court. Can 'Bharat Electricals' do this? Why? Also explain 'who is a consumer' as per Consumer Protection Act, 2019.

Answer:

I) Bharat Electricals cannot file a complaint. This is because Bharat Electricals is not a consumer as per Consumer Protection Act, 2019 because they bought the goods for resale/commercial purpose.

II) As per Section 2(7) of the 2019 Act, consumer is any person who buys goods or avails any service for a consideration and includes any user except for the person who has availed such services or goods for the purpose of resale or commercial use. The explanation to the definition specifically states that the expression "buys any goods" and "hires or avails any services" includes all online transactions conducted through electronic means or direct selling or teleshopping or multi-level marketing. Online transactions is an exclusive feature of this act and added keeping in mind the growing e-commerce business and advancement in technology.

PRACTISE QUESTIONS:

1. On Sonika's birthday her mother gave her a pair of gold earrings. After one month Sonika observed that the ear-rings are losing their shine. She checked the mark on the ear-rings and found that it was not a proper Hallmark and her mother had been cheated by the shopkeeper. So, she filed a complaint in the district forum which rejected it. Not satisfied by the decision of the district forum, she was very much disturbed and after two months decided to appeal further. Can Sonika appeal against the decision of the district forum? Give reason in support of your answer.

2. Himanshu purchased a new car from 'Galaxy Motors' for ₹ 25 lakhs. He was offered free insurance for the first year and three free servicing to be availed after the car had covered 5,000 km, 10,000 km and 15,000 km respectively. When Himanshu took the car for the first free servicing, he was told that the car was not new and first service had already been available on this car. He felt cheated and filed a complaint in the State Commission. Being not satisfied with the decision of the State Commission, after two months he decided to file an appeal against it. Can Himanshu appeal against the decision of the State Commission? Give reason in support of your answer.

3. Manuj bought a packet of chips from a local shopkeeper and found that the ingredients given on the label were not legible. He complained about it to the company. The company sent a written apology stating that they will make sure that existing packets are withdrawn from the market and new packets with legible labels are soon made available. State the consumer right which Manuj exercised.

4. Suman bought a box of cheese of a reputed brand from a local shopkeeper. On opening the box she found a piece of stone in the cheese. She reported the matter to the shopkeeper who forwarded her

complaint to the concerned company. Within a week the representative of the company visited Suman's residence with an apology and as a replacement offered her a new cheese pack with four other varieties of cheese as compensation for the inconvenience to her. State the consumer right which Suman exercised.

5. Manvendra always went to a specific shop to buy all consumable and non-consumable goods. In this shop a variety of products of different brands were displayed nicely and the salesperson available also gave a good sales presentation if required. But this shop was quite far off from his residence. His friend Annant always wondered why Manvendra wastes so much time in going to that shop where there were many big brand shops situated near his residence having consumable and non-consumable goods. Annant asked Manvendra the reason for going to that particular shop. Manvendra said that he was exercising one of his 'Rights' which he could not exercise in nearby big brand shops. State the consumer's right which Manvendra had exercised.

6. On the eve of Diwali Ravi purchased two kilograms of sweets from Nandan Sweets. On consumption of sweets his wife fell sick and was to be hospitalized. Ravi wanted to file a case in the consumer forum but could not do so because he did not have any proof of buying the sweets from Nandan sweets. Name the document that Ravi could have obtained for filing the complaint in the consumer forum.

7. Pankaj purchased a car from 'Abhishek Motors' for Rs. 50 lakhs. The company offered many attractive gifts to Pankaj like - free insurance for first two years, free pick-up and drop facilities for free servicing upto 20,000 km, etc. But after a few days Pankaj noticed that the pick-up of the car was not good and there were some problems in the engine. The company serviced the car free of cost but even then Pankaj was not satisfied with its performance. 'Abhishek Motors' is not giving him the due response. So he filed a complaint in the State Commission but was not satisfied with its decision also. He was very much disturbed and after two months decided to appeal against it. Can Pankaj appeal against the decision of the State Commission? Give reason in support of your answer.

8. On Sonika's birthday her mother gave her a pair of gold earrings. After one month Sonika observed that the ear-rings are losing their shine. She checked the mark on the ear-rings and found that it was not a proper Hallmark and her mother had been cheated by the shopkeeper. So, she found a complaint in the district forum which rejected it. Not satisfied by the decision of the district forum, she was very much disturbed and after two months decided to appeal further. Can Sonika appeal against the decision of the district forum? Give reason in support of your answer.

9. The consumer has the right to acquire knowledge and to be a well informed consumer throughout life.' State what type of knowledge is required by the consumer in the above stated 'Right'.

10. Under three-tier machinery, where can a legal heir or representative of a deceased consumer file a complaint where the compensation claim is Rs 2,5 crores?

11. Pragya bought an iron of a reputed brand for Rs 1,500 but it caused an electric shock while it was being used. Pragya wants to exercise her "Right". Identify the "Right" under which she can be protected.

12. Reena purchased one litre of pure Desi Ghee from a shopkeeper. After using it she had a doubt that it was adulterated. She sent it for a laboratory test which confirmed that the Ghee is adulterated. State any six reliefs available to Reena, if she complains and the consumer court is satisfied about the genuineness of the complaint.

13. .Prakhar purchased an ISI mark electric iron from 'Bharat Electricals'. While using it he found that it was not working properly. He approached the seller and complained about the same. The seller satisfies Prakhar by saying that he will ask the manufacturer to replace this iron. The manufacturer refused and Bharat

Electricals decided to file a complaint in the consumer court. Can 'Bharat Electricals' do this? Why? Also explain 'who is the consumer as per Consumer Protection Act, 2019.

14. Mukul purchased a house for Rupees 30 lakhs from a housing company and found it to be defective. Despite many complaints the defect was not rectified. He filed a complaint in the state commission but was not satisfied with the order. Where can be appealed and in how many days.

15. A farmer purchased seeds worth Rs. 20,000 from "Bharat Fertilisers" for agricultural purposes. The seeds were very costly as they were of hybrid variety. After 6 months he noticed that the agricultural produce was not upto expected standard. He reported this matter to the seller, but he refused to accept the liability. Mention the redressal agency in which he can file a complaint.

16. On securing 95% marks in class XII, Ram's father gifted him a gold chain. But after 2 months, Ram noticed that the gold chain was losing the shine. He checked that the mark on the chain was losing the shine. He checked the mark on the chain and found that it was not a proper hallmark (BIS). He lodged a complaint in the district forum, which rejected it. Not satisfied by the decision of the district forum, he was very much disturbed and after 45 days, he decided to appeal further.

Can Ram appeal against the decision of the district forum? Give reasons in support of your answer. 17. Tanya purchased some household goods from a "General Store" on reaching home, she found that one face cream, (Rs. 250) had not been billed. She was happy that she got it without paying for it. After checking the expiry date and other details, she started using it. Her face burnt due to the use of cream.

(1) Where should Tanya file the complaint for the cream? Justify.

(2) Which values have been violated here?

18. 'Sehaj bought Teak wood furniture for his drawing room from "Akshay Decors" of Kirti Nagar, Delhi for Rs. 4 lakhs. At the time of purchase the firm assured sehaj about the best quality of the said furniture and gave 2 years warranty stating that if anything goes wrong, the firm shall replace it with a new one or refund the purchase amount. But the dining table and chairs started developing cracks at various places and the polish became very dull within 30 days of purchase. Sehaj reported the matters to the firm and requested a number of times to replace the furniture. The firm neither paid attention to these requests nor replaced the furniture.

(1) Identify the consumer rights which have been violated by the furniture manufacturer.

(2) Where can Sehaj lodge a complaint for this?

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