December 2008

ECO-1: BUSINESS ORGANISATION

SECTION A

1. Attempt any four of the following: (5+5+5+5)

(a) State the main features of company form of organisation.

Ans: Features of company form of organisation are as follows:

Incorporation: A company is an incorporated association. It comes into existence only after registration under the Companies Act.

Artificial person: A company is regarded as an artificial person as it is created by law and can be effaced only by law. It has no body, no soul, no conscience, still it is in a position to exist. Like any other person it can own property, conduct a lawful business, enter into contracts with others, buy, sell and hold property, all under its own name and its own seal.

Common seal: As the company is not a natural person, it cannot sign the documents. It has a device in the form of common seal on which its name is engraved. This common seal is a substitute of its signatures. It is affixed on all important legal documents and contracts.

Separate Legal Entity: A company has a distinct entity and is independent of its members or people controlling it. A separate legal entity means that only the company is responsible to repay creditors and to get sued for its deeds. The individual members cannot be sued for actions performed by the company. Similarly, the company is not liable to pay personal debts of the members.

Perpetual Existence: A joint stock company has a continuous existence. Unlike other non-registered business entities, a company is a stable business organisation. Its life doesn't depend on the life of its shareholders, directors, or employees. Members may come and go but the company goes on forever.

Number of members: In the case of a public limited company: the minimum number is seven and there is no maximum limit. In the case of a private limited company, minimum number is two and the maximum is fifty.

Limited liability: The liability of the members of a company is normally limited by guarantee or by the shares. Members liability is limited to the amount of shares held. Members are not personally liable for the debts of the company. So, personal properties of the members are not liable to be attached for the payment of the company's debts.

Transferability of shares: In public limited company, members have the rights to sell his shares to others without the consent of other shareholders. However, there are restrictions for transferring shares in case of a private limited company.

(b)Enumerate any five functions of an entrepreneur.

Ans:1. Develops an idea and explores opportunities: The idea of forming a business unit is first formed in the creative mind of the entrepreneur. On the basis of the idea, he perceives opportunities for profitable investments and explores the prospects of starting a manufacturing enterprise.

2.Decides form of organisation: He decides the form of business ownership, i.e., whether it should be a sole proprietorship, a partnership firm, a company or a cooperative society.

3. Decides location: He decides location of the factory at a suitable place taking into account the available facilities of transport, power-supply, fuel, water, labour, supply of raw-materials, nearness of market, etc.

4.Places orders for machinery: He places orders for machinery, equipments and other requirements. He takes decision about the installation of equipment and machinery in the process of production.

5.Recruitment of labour: As an entrepreneur he makes an estimate of skilled and unskilled workers of different categories required for various departments. Accordingly, the entrepreneur arranges their recruitment.

6.Designs internal organisation structure: He designs internal organisation structure for his proposed concern. This involves breaking up of the total work of the enterprise into major functions like production, marketing, finance, personnel, purchase, engineering, etc. and the dividing of each of them into sections.

(c)What do you understand by bank overdraft and cash credit facilities as a source of short-term finance?

Ans: Cash credit refers to an arrangement on a continuing basis whereby the commercial bank allows money to be drawn as advance from time to time within a specified limit known as cash credit limit. This facility is granted against the security of goods in stock, or promissory notes bearing a second signature, or other marketable instruments like Government bonds. The company is allowed to draw whatever amount is required at different times within the limit agreed upon. The cash credit limit may be revised according to the value of securities. The money drawn can be repaid as and when possible. Interest is charged on the actual amount withdrawn. It is offered for maintaining the working capital of the business. The loan duration is generally 1 year.

Overdraft is a temporary arrangement with the bank which permits the company to overdraw from its current deposit account with the bank up to a certain limit. The overdraft facility is also granted against securities as in the case of cash credit. Interest is charged only on the amount actually overdrawn. Overdraft facility is offered for meeting short-term obligations of individuals or businesses. The loan duration can vary and it can be monthly, quarterly, half yearly or yearly.

d)Explain the concept of 'underwriting' of securities.

Ans: Development banks and financial institutions underwrite the issue of shares and debentures of public limited companies. Investment trusts, stock-brokers. issue houses and other similar organisations also underwrite the public issue of shares and debentures. Those who underwrite security issues are known as Underwriters. Underwriting refers to an agreement between the promoters or directors of a company on one hand, and an individual, firm or institution (known as underwriter) on the other, whereby the latter agrees to take up the whole or part of the shares or debentures issued which may not be subscribed by the public. In consideration of the undertaking given by the underwriter, the company agrees to pay a commission which is known as 'underwriting commission'. Underwriting commission is generally a percentage of the issue price of the shares or debentures underwritten.

There is a written agreement between the company and the underwriter known as the 'Underwriting Agreement' (or Contract). A contract generally contains the following:

i) The number of shares or debentures which are agreed to be underwritten.

ii)An undertaking by the underwriters to take up such of the shares or debentures as are not subscribed by the public.

iii) An undertaking by the company that the terms of issue given in the prospectus will not be changed without the consent of underwriters.

iv) The rate of commission to be paid to the underwriters and the mode of payment.

v)Authority of the underwriters to the company to allot them the balance of shares or debentures not taken up by the public.

The most important advantage of underwriting, to the promoters is that the funds required for the enterprise become available whether or not there is adequate public response to the issue of shares and debentures. Another advantage of underwriting is that the company gets the benefit of expert advice from the underwriters. The only disadvantage of underwriting is that it adds to the cost of raising finance. Any individual, partnership firm, company or financial institution may become an underwriter. They may be regarded as underwriting agencies or institutions. In India, the development banks, commercial banks, investment companies, investment trusts and stock brokers (share brokers) engage in underwriting business. Some of the well-known underwriting agencies in India are IFCI,IDBI,LIC,UTI,State Bank of India, Bank of Baroda etc...

e) What are the advantages of listing of securities on a stock exchange?

Ans: All securities issued by companies and other bodies are not traded in stock exchanges but only the listed securities are traded. Listing means addition of new securities to the existing list of securities being traded on a stock exchange. If a joint stock company or any other body who has issued new securities wants them to be traded on the floor of stock exchange and their prices duly published, it has to get the securities included in the list of the stock exchange. For listing, the company has to make an application and furnish the prescribed information to the stock exchange.

Advantages of Listing:

The main advantage of listing of securities is that the investor gets all the required information about the securities he wants to buy or sell. Certain other advantages of listing are:

1. It provides a continuous market for securities.

2. It enhances the prestige of the company.

3. It provides an indirect check against manipulation of prices by the management.

From the point of view of a company, listing of securities is beneficial in two ways:

i) it enhances credit worthiness of the company, and

ii) it widens the market of the securities. From the point of view of investors, listing provides safety of dealing and liquidity.

(f) Distinguish between, Advertising' and 'Publicity.

Ans: Advertising:

The activity of generating advertisements of products and services to commercialize them is known as Advertising. It is what the company says about its product. There is a huge investment to be made for advertising a single product. The key persons behind advertising are the company and its representatives. Advertising is under the control of the company. Advertising repeatedly occurs to grab the attention of the customers. Advertising is always customer focused, i.e., the more creative the advertise, the more are the customers attracted to it. Advertising always speaks the goodness about a product, to persuade the target audience to buy it. In contrast to publicity, the company has to pay money to the media for the space or time used. There is an identifiable sponsor. Normally, a company sponsors it for its product or service.

Publicity: The activity of providing information about an entity, i.e., a product, an individual or a company to make it popular is known as Publicity. It is what others say about the product. Publicity does not require any kind of investment. Publicity is done by a third party which is not related to any company. Publicity is not under the control of the company. Publicity is done only one-time act. Publicity is not done keeping customers in mind. Publicity, it is unbiased, and so it will speak the reality, no matter whether it is goodness or illness. Company does not make any payment to the media for the time or space used for publicity. There is no identifiable sponsor. Media presents the information voluntarily.

(g) Briefly explain the nature of banker's right of general lien.

Ans: One of the most important rights enjoyed by a bank is the right of general lien. Lien is a right of a person to retain goods belonging to another; until the demands of the person in possession are satisfied. Section 17 1 of the Indian Contract Act confers the right of general lien on the bankers. The banker can exercise his right of general lien only as a banker and not as a bailee. Banker's lien is an implied pledge in the sense that if a default is made by the debtor, the banker can, after giving a reasonable notice to the customer, sell the goods in his possession and recover the amount. If some valuables are deposited with a bank for safe custody, then it is bailment and the bank cannot exercise the right of general lien.

Right of general lien cannot be exercised in the following cases:

a) When valuables are deposited for safe custody,

b) When money or documents are deposited for a specific purpose,

c) When some securities are left with the bank by mistake,

d) When the property is held by the customer as trustee and the bonk has the notice of trust, and

e) When there is an express agreement that the bank shall not exercise the right of general lien.

(h) Comment on the sales policy of public utility undertaking.

Ans: The products or services offered by public utilities are 'essential' requirements of the public and have usually large demand from the public. The public utilities do not generally have rivals or competitors. A particular product is supplied by one undertaking in a particular area. So, there is no possibility of different rates being charged by different producers in the same area. So, there is no necessity for price discount. These undertakings are granted franchise by the government. They had the right to interfere with private property as well as right to use public property (roads, land, buildings, etc.). There are no middlemen or intermediaries for sale of their products or services. They sell directly to their consumers or sell through their own distribution network. For example, water supply, electric supply, and transport undertakings come in direct contact with the consumers. Therefore, they have to offer best possible terms to users, of these services. Unlike other commercial concerns, public utility undertakings do not have the problems of credit collection from the customers. In some cases, as in electricity undertakings, the supply is stopped if there is default in payment of bills by a specified date. In some cases, the dealings are on cash basis, as in railways and road transport undertakings. There is no necessity for the public utility undertakings to advertise their goods and services like other business units. However, they have to inform the public about the service which they provide. For example, a transport undertaking has to keep the public informed about the new services introduced from time to time on different routes, changes in the routes, changes in the timings, etc. Such information facilitates the customers in utilising the service which ultimately leads to utilisation of full capacity.

Section B

Attempt any three of the following

2. What are the special features of a cooperative form of organisation ? Explain its merits and limitations. (4+3+3)

Ans: Cooperative organisations are generally started by the poor and the economically weak sections to promote their common economic interests through business propositions. The primary objective of any cooperative organization is to render service to its members. The important features of the cooperative organization are service in place of profit, mutual help in place of competition, self-help in place of dependence and moral solidarity in place of unethical business practices.

Features of Cooperative form of organisation:

1. Voluntary Association:

A cooperative so-ciety is a voluntary association of persons and not of capital. Any person can join a cooperative society of his free will and can leave it at any time. This has two important connotations:

i)Any person can become a member irrespective of his caste,creed,religion,colour,sex etc.

ii)The members come together to form themselves into an association without any coercion or intimidation.

2. Democratic Management:

An individual member is considered not as a capitalist but as a human being and under cooperation, economic equality is fully ensured by a general rule—one man one vote. Irrespective of the number of shares held by any member, all enjoy equal rights and equal duties.

3. Capital:

Capital of a cooperative society is raised from members through share capital. Cooperatives are formed by relatively poorer sections of society; share capital is usually very limited. The major part is raised either by way of loan from the government and the central cooperative banks.

Autonomy and stability: A cooperative society is a self-governing organisation. It is self-sufficient, self-renewing, and self-controlling within its jurisdiction. A cooperative organisation also enjoys a separate and independent entity distinct from that of its members. It has a perpetual life and is not affected by the entry and exit of members.

Service motive: The primary objective of any cooperative society is to provide service to its members.

Limited return on capital: In cooperative system, profits are distributed among the shareholders for the capital they have contributed. But the rate of dividend paid to the shareholders is limited to 9% as per the Cooperative Societies Act.

Distribution of surplus: In case of cooperative societies, after giving a limited dividend to shareholders, the surplus profits are distributed in the form of bonus.

Merits of Cooperative form of organisation:

1. Ease of formation:

It is quite easy to form a cooperative society. Any ten adults can join together and form themselves into a cooperative. Very little time and money are required to get a cooperative registered. The legal formalities are very few and simple.

2. Open membership:

Any person having a common interest can become members of a cooperative society and can leave the society at his own pleasure. No discrimination is made on the basis of caste, creed, religion or political affiliation. The cost of a share is low and even poor persons can buy it.

3. Limited liability:

The liability of every member is limited to the extent of his share in the society's capital. Therefore, the risk faced by every member is limited and known.

4. Continuity and stability:

After registration, a cooperative society becomes a separate legal entity. The death, lunacy, or insolvency of a member does not affect its existence. Therefore, it enjoys continuity of operations.

5.Supply of goods at cheaper rates: The societies purchase goods directly from producers and sell them to the members at cheap rates. The middlemen are eliminated from the channel of distribution. The

consumer cooperatives supply essential goods to the members at a time when there is scarcity of goods in the market. Cooperative societies ensure regular supply of goods at cheaper rates.

6.State assistance:

The Government provides several concessions to cooperative societies in the matter of taxes, finance, etc. A cooperative society enjoys special privileges and exemp-tions.

Limitations of cooperative form of organisation:

1.Coordination: Internal dissensions and rivalries among the members diminish much of its strength and vigour. The absence of coordinated and joint action is responsible for the collapse of many cooperative associations.

2.Corruption: One of the most important drawbacks of a cooperative form of organisation is the prevalence of corrupt practices in the management and functioning of the cooperative societies.

3.Lack of secrecy: The affairs of cooperatives are generally exposed to the members and it becomes quite difficult for them to maintain secrecy in business affairs.

4.Insufficient motivation: Since the rate of return on capital is low, the members do not feel involved in the affairs of the society.

5.Lack of interest: Sustained efforts over a period are the prerequisites for success in any business. But such a state of affairs does not exist in many cooperatives. Within a short period of its dramatic start, the cooperative becomes lifeless and inactive in its operation.

3. Describe the role of an entrepreneur in business promotion. How does an entrepreneur differ from a promoter?(6+4)

Ans: Ans: Role of an entrepreneur in business promotion:

1)Develops an idea and explores opportunities: The idea of forming n business unit is first formed in the creative mind of the entrepreneur. On the basis of the idea, he perceives opportunities for profitable investments and explores the prospects of starting a manufacturing enterprise.

2)Product analysis and market survey: He collects data on consumer preferences and needs through market research techniques and to find out the sale-ability of the proposed product. Further, he collects consumer preferences in respect of design, colour, size and shape. In addition, the entrepreneur gathers the total demand and the degree of competition for the proposed product.

3)Decides form of organisation: He decides the form of business ownership, i.e., whether it should be a sole proprietorship, a partnership firm, a company or a cooperative society.

4) Decides location: He decides location of the factory at a suitable place taking into account the available facilities of transport, power-supply, fuel, water, labour, supply of raw-materials, nearness of market, etc.

5) Collects necessary capital: He makes available sufficient amount of capital for the initiation and continuation of the business. He gives personal guarantees to the financiers who contribute capital. Otherwise, he promises to invest capital himself or arrange the necessary amounts from friends and

relatives. In case of small enterprises, the promoters can provide funds from their own savings. But in case of large enterprises, funds have to be raised from various sources like general public, commercial banks, financial institutions, etc.

6)Places orders for machinery: He places orders for machinery, equipments and other requirements. He takes decision about the installation of equipment and machinery in the process of production.

7) Recruitment of labour: As an entrepreneur he makes an estimate of skilled and unskilled workers of different categories required for various departments. Accordingly, the entrepreneur arranges their recruitment.

8) Designs internal organisation structure: He designs internal organisation structure for his proposed concern. This involves breaking up of the total work of the enterprise into major functions like production, marketing, finance, personnel, purchase, engineering, etc. and the dividing of each of them into sections. He stipulates the functions of different departments and their inter-relationships.

9) Fulfils formalities and launches enterprise: Every type of business has some procedural formalities while starting a new enterprise. The formalities are different for different types of business organisations. Unless you fulfil them, you cannot simply launch an enterprise.

Difference between Entrepreneur and Promoter:

Those who are innovators and risk-bearers are strictly known as 'entrepreneurs' while those who take steps to set up the business and make it operational are known as 'promoters'. The entrepreneur is someone who comes up with the idea/solution and/or develops a business around it. Those who take steps to set up the business and make it operational are known as 'promoters'. Entrepreneurs may or may not be specialists in the field of business. Promoters are basically specialists who work to set up a new business, expand an existing business or combine two or more business firms. An entrepreneur can be a promoter but a promoter may or may not be an entrepreneur. In actual practice, such distinction does not hold well because Entrepreneurship (act of Entrepreneurs) does not remain confined only to identifying a business opportunity and his preparedness to do something new. It does not end with the entrepreneur undertaking to bear the risks of business. It also extends to planning for the business and taking necessary steps to put it into operation. After all, a business becomes a business only when it gets going. An entrepreneur is basically someone who has founded the company. A promoter, on the other hand, is someone who promotes the business. An entrepreneur is fully responsible for the company’s success or failure. Promoter is responsible for getting others to invest into the business venture.

4. What do you mean by capital structure? Explain the factors determining the capital structure of a firm. (3+7)

Ans: The proportion of fixed interest-bearing capital in the total capital is known as capital gearing. The capital is, thus, said to be highly geared if borrowed. capital is, proportionately very high in relation to the ownership capital. Correspondingly, low gearing of capital signifies a smaller proportion of borrowed capital compared with the ownership capital. The composition of the total capital consisting partly of long-term funds with fixed charge and partly of ownership funds is known as the capital structure. Thus, capital structure refers to the relative proportion in which various sources of long-term finance are used to meet the total financial requirements, like debentures and long-term loans, preference share capital, and equity capital (including reserves and surplus).

Factors determining the capital structure of a firm are:

1.Nature of the business: If a company is engaged in business activities in which sales are subject to wide fluctuations, it is desirable to have a smaller proportion of borrowed funds. Companies manufacturing televisions, refrigerators, machine tools and capital goods are normally subject to fluctuations in sales from time to time. Companies dealing in essential consumer goods of daily use are products having inelastic demand generally have stable earnings, and thus may depend to a greater extent on borrowed capital.

2. Characteristics of the company: The size of a company as well as its credit standing also determines the extent to which equity or debt capital should be raised. Small firms have to depend more on owners' funds as it is difficult for them to raise long-term loans. This is because investors consider lending to small firms to be riskier. In contrast, large companies must make use of different sources of raising funds as no single source can meet their total financial requirements. Normally investors prefer to lend money to large companies as they believe that their money is safe and the risk is less with big business firms.

3. Cost of finance: Since interest paid on borrowings is chargeable to profits before tax calculation, the cost of debt financing is inevitably lower than the expected rate of earnings (i.e., profitability) on equity capital. Hence, it is always beneficial to raise part of the total financial requirement through long-term loans. With lower cost of debt financing, the overall (average) cost of financing is reduced, and the return on equity capital is higher. This is one of the important determinants of the capital structure.

4. Flexibility of capital structure: The capital structure decision is usually made by management keeping in view their ability to adjust the sources of funds. The scope of changing the capital structure in future happens to be a basic consideration. For instance, in case additional funds are needed, a firm which is already financed with heavy debt may be forced to issue equity shares with a higher cost of finance involved. Or, again if funds raised are to be refunded on account of declining business, a firm may be unable to do so if it earlier relied heavily on equity capital.

5. Availability of cash (cash flow): The ability of a business to discharge its fixed obligations depends essentially on the availability of liquid cash. Profits earned may be adequate to cover the fixed charges arising out of debt, but the firm may not have sufficient cash to pay as the income gets continually invested in the form of more inventory, book debts or even purchase of equipment. Hence, besides profitability, it is necessary to estimate the cash flows before deciding on the proportion of debt in the capital structure.

6. Expected earnings in relation to interest charges: Another factor determining debt-equity ratio is the estimated coverage of interest by profits. If the average earnings of the company are expected to be three to four times the amount of interest payable on borrowed capital, it may be considered safe to raise long-term loans rather than equity capital. Three to four times coverage of interest by earnings is regarded as a reasonable assurance that interest payment would be possible even if profits decline substantially.

7. Effect of debt financing on the earnings per equity share: The effect of debt on the rate of return on equity (or earning per share) is known as 'trading on equity' or 'leverage effect', Thus in business ventures with assured prospect of rising income, there is greater emphasis on debt capital in the capital structure.

8. Management control: Promoters who had major shareholding and control the management of the company take into account the probable effect of raising funds through the Issue of equity shares. Equity shareholders having voting rights can influence the policy decisions of the company or the selection of directors. But the persons who give loans do not have any right to elect directors or to participate in the management of the company. Hence the existing management group, in order to retain their control over management, prefer to raise additional finance through the issue of debentures and preference shares.

5. Explain briefly the importance of stock exchange in a modern society and state its shortcomings. (6+4)

Ans: A stock exchange is often the most important component of a stock market. Stock exchange is an organisation which provides facilities for the purchase and sale of existing securities. Stock exchange as a market or a place where different types of securities are bought and sold. It not only deals in shares and debentures but also in various other types of securities issued by central, state and local governments as well as institutions like Unit Trust of India, Steel Authority of India, National Thermal Power Corporation, etc. Therefore, it is also called 'securities market' or 'securities exchange'. It is a secondary market of securities because only the securities already issued are allowed to be dealt with on the floor of a stock exchange. This market is open only to members, most of whom are brokers acting as agents of the buyers and sellers of shares, debentures and bonds. A stock exchange is generally organised as an association or a society or a company. The membership of the stock exchange is restricted to a certain number, and new members are admitted only when there are vacancies. Every member has to pay the prescribed membership fee.

The Securities Contracts (Regulation) Act, 1956 has defined stock exchange as an 'association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in Securities'.

Stock markets exist to serve the wider economy. It helps individuals earn a profit on their income when they invest in the stock market and allows firms to spread their risks and receive large rewards. The stock market plays an important role in the economy of a country in terms of spending and investment. Without stock markets, many countries would not be as developed as they are. It also enables the government to increase spending through the tax revenue they earn from corporations that trade on the stock exchange. The government uses the revenue to increase re-investment and employment capacity.

Alongside this, it has helped individuals become wealthy and increases the overall standard of living in many economies. Following are some of the most important functions of a stock market in the economy:

Stock market helps companies raise capital: If stock markets did not exist, companies would have to resort to borrowing from the bank to raise money for expansion. This would be a burden on the company as they would have to repay the loans with interest.

Stock market helps create personal wealth: One of the most important benefits of the stock market is its ability to help generate personal wealth in the economy. For the individual investor, the stock market provides a way to invest your income to earn a share of the companies’ profits.

It helps increase investment in the economy: The stock market is considered to be one of the most prominent sources for people to invest money in. Furthermore, investors are always looking to invest in companies with high growth potential.

Fortunately, with stock markets, businesses have the ability to create an initial public offering and raise large amounts of cash without having to worry about repayment. The stock market gives opportunities to businesses and the public to transfer capital and ownership in a controlled, secure and managed environment.

In addition to providing a convenient way for companies to raise capital and for individuals to increase wealth, the stock market helps keep a check on corporate regulation and increases the economic growth and prosperity of the nation.

Shortcomings of stock exchange: Like other institutions, stock exchanges too are not free from limitations. If operations on stock exchanges are not controlled, they may be harmful to companies as well as investors. Let us, therefore, examine the shortcomings of the stock exchanges. The shortcomings or stock exchanges arise out of brokers' and jobbers' tendency to engage in speculative buying and selling of securities without legitimate.

Excessive speculation: It is one of the common evils associated with stock exchange operations. Speculation implies buying or selling securities in anticipation of future prices. Speculators generally deal in securities with the main objective of gaining from the difference in prices. They do not have the intention of paying for the securities or taking delivery of securities if they are speculative buyers. Prices go up just because they make bids to buy. On the other hand, speculative sellers, do not possess the securities, nor do they intend to receive payment and deliver securities. But, their bids to sell pushes prices down. When there is no genuine reason for prices to move up, high prices may suddenly crash if buyers are required to pay for the securities which they cannot generally do for lack of funds. Similarly, if the sellers are required to deliver securities, they may not be able to do so. This kind of situation does not permit real investors to rely on the changes in securities prices as an index of the future prospects of a company.

Wide fluctuations in prices: Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as due to rumours which may be spread by interested parties. Sudden changes in social, economic and political factors are not easily predictable.

Speculators with knowledge and skill normally help to reduce price fluctuations. But when rumours are spread by speculators only to raise or reduce prices of particular securities for their own profit, there is excessive rise or fall of prices, and genuine investors are unable to decide whether to buy or sell. Many of them get panicky when prices of securities steeply decline. Others buy in haste just because prices are rising. In both cases, the investors may repent for selling or buying securities which may lead to losses.

6.'Advertisement is a waste.' Comment (10)

Ans: Though advertising is one of the most frequently used medium of promotion of goods and services, it attracts lot of criticism. The opponents of advertising say that the expenditure on advertising is a social waste as it adds to the cost, multiplies the needs of people and undermines social values. The proponents, however, argue that advertising is very useful as it increases the reach, brings the pay unit

cost of production down and adds to the growth of the economy. It is therefore, important to examine the major criticisms against advertising and see the extent to which these are true. This is taken up as follows:

1. Adds to Cost: The opponents of advertising argue that advertising unnecessarily adds to the cost of product, which is ultimately passed on to the buyers in the form of high prices. An advertisement on TV, for a few seconds, for example, costs the marketers several lakhs of rupees. Similarly, an advertisement in print media say in a newspaper or a magazine costs the marketers a large amount of money. The money spent adds to the cost, which is an important factor in fixation of the price of a product. True, advertisement of a product costs lot of money but it helps to increase the demand for the product as large number of potential buyers come to know about the availability of the products, its features etc. and are persuaded to buy it. The increased demand leads to higher production, which brings with it the economies of scale. As a result, the per unit cost of production comes down as the total cost is divided by larger number of units. Thus, the expenditure on advertisement adds to the total cost but the per unit cost comes down which in fact lessens the burden of consumers rather than adding to it.

2. Undermines Social Values: Another important criticism of advertising is that it undermines social values and promotes materialism. It breeds discontent among people as they come to know about new products and feel dissatisfied with their present state of affairs. Some advertisements show new life styles, which don't find social approval. This criticism is not entirely true. Advertisement in fact helps buyers by informing them about the new products, which may be improvement over the existing products. If the buyers are not informed about these products, they may be using inefficient products. Further, the job of an advertisement is to inform. The final choice to buy or not to buy anyway rests with the buyers. They will buy if the advertised product satisfies some of their needs. They may be motivated to work harder to be able to purchase these products.

3. Confuses the Buyers: Another criticism against advertisement is that so many products are being advertised which makes similar claims that the buyer gets confused as to which one is true and which one should be relied upon. For example, we may note similar claims of whiteness or stain removing abilities in competing brands of detergent powder or claims of whiteness of tooth or 'feelings of freshness' in competing brands of toothpaste that it is sometimes confusing to us as to which one to buy. The supporters of advertisement, however, argue that we are all rational human beings who make our decisions for purchase of products on factors such as price, style, size, etc. Thus, the buyers can clear their confusion by analysing the information provided on the advertisements and other sources before taking a decision to purchase a product. However, this criticism cannot be completely overruled.

4. Encourages Sale of Inferior Products: Advertising does not distinguish between superior and inferior products and persuades people to purchase even the inferior products. In fact, superiority and inferiority depends on the quality, which is a relative concept. The desired level of quality will depend on the economic status and preferences of the target customers. Advertisements sell products of a given quality and the buyers will buy if it suits their requirements. No advertisement should however, make false claim about the quality of a product. If a firm makes a false claims it can be prosecuted for the same.

5. Some Advertisements are in Bad Taste: Another criticism against advertising is that some advertisements are in bad taste. These show something which in not approved by some people say advertisements showing women dancing when not required or running after a man because he is

wearing a particular suit or using a particular perfume are certainly not good. Some advertisements distort the relationship like employer employee and are quite offensive.

6.Advertising leads to monopoly: Small competitors find it difficult to enter the market due to advertising. This is because large firms create hurdles in their way.

7.Advertising causes undesirable social effects: Certain social effects can be. there due to advertising like it influences the materialistic values and life styles of people in society, certain sex and, horror appeals are used in order to draw the consumers attention, it creates frustration and disappointment when a person cannot purchase and enjoy a particular product.

8. Advertising results in inefficient resource allocation: Advertisements are intended not so much for the benefit of consumers. They are mainly directed to influence the consumer demand to fit whatever has been produced. In other words, advertisements are aimed mainly to change the tastes of people so that they will buy whatever is manufactured. This leads to distortion in consumption expenditure and increases the producers market power. Thus, advertising indirectly determines what people should consume. In this process productive resources i.e., land, labour and capital, may not be used in the best interest of the society.

9. Advertising may act against the freedom of press: Mass media earn huge income from advertisements. If the media are dependent on income from advertisements sponsored by few large business firms, it may be difficult to disseminate information in public interest when it is unfavourable to those big business firms. Big sponsoring firms can threaten the media owners by refusing their advertisements and dictate what media have to do. Thus, the financial dependence of media on advertisements may act against the freedom of press.

OR

Discuss the factors which influence the choice of distribution channel. (10)

Ans: The channel of distribution is a network of institutions that perform a variety of interrelated and coordinated functions in the movement of goods from producers to consumers.

We can classify the distribution channels into two broad categories: (1) direct channels, and (2) indirect channels (use of middlemen).

1) Direct Channels: When the producers sell their goods directly to the consumers it is called a direct channel. No middlemen are present between the producer and the consumer.

2)Indirect channels: In the case of all the products it is not possible for the manufacturer to supply goods directly to the consumers. So may be middlemen like wholesaler, retailer and mercantile agents may be engaged in the channel of distribution. When the middlemen are engaged, it is called an indirect channel.

The following factors generally influence the choice of the channel of distribution:

1) Distribution policy

2)Characteristics of the product

3) The target customers in view

4)Supply characteristics

5)Types of middlemen in the field

6) Channel competition

7) Potential volume of sales

8) Costs of distribution

9) Profits expected in the long-run

1)Distribution policy: Where the manufacturer is interested in distributing his products through all possible outlets, it is desirable to use more than one channel to reach the target customers. This is known as intensive distribution policy. The purpose in this case is to make the product available as near to the consumers as possible. Consumer goods of frequent use like pens, pencils, paper, soap, hair nil, etc., are distributed through a large number of wholesalers and retail traders. If goods are meant for customers who are very particular about their quality and usefulness, manufacturers adopt a selective distribution policy.

2)Characteristics of the product: The nature of the product influences the choice of channel. For example, perishable products like eggs, milk, etc., are supplied either directly ors through the short' channels. In the case of heavy and bulky products (e.g., cement, steel) where distribution and handling costs are higher, short channels are preferred. Sophisticated electrical and electronics equipment which require careful handling are also generally distributed directly or through short channels. On the other hand, long channels are found in the case of light-weight and small-size items like dress material, readymade garments, pocket calculators, stationery, toothpaste, toothbrush, etc. Similarly, simple mechanical products like electronic toys, time-clocks, etc., are supplied through long channels for intensive distribution.

3)Characteristics of target customers; If the number of customers is large and geographical area is extensive, long and multiple channels are necessary for intensive distribution of goods. This is also suitable where the consumers are in the habit of making frequent purchases of small quantities at irregular intervals. Short channels and direct selling are possible in the case of few customers who purchase large quantities at regular intervals and they are concentrated in a small area.

4)Supply characteristics: Goods produced by a small number of producers concentrated in one region are generally distributed through short channels. Long channels are suitable if a large number of producers in different regions produce and supply the goods.

5)Types of middlemen: Availability of suitable middlemen in the channel of distribution is another factor in the selection of the channel. This is because different functions like standardisation, grading, packing, branding, storage, after sale servicing, etc., are expected to be performed by middlemen. Efficiency of distribution depends upon the size, location and financial position of middlemen. If the middlemen in a specific channel are dependable and efficient that channel may be preferred by producers.

6)Channel competition: There are different situations in which manufacturers compete with each other for availing the services of particular wholesalers. Similarly, wholesalers often compete with each other to deal with particular retailers or carrying particular brands of products. Sometimes producers use the

same channel which is used by their competing producers. If any producer arranges exclusive distribution through a particular wholesaler, other producers also do the same. Thus, selection of a channel may depend on the competition prevailing in the distribution system.

7)Potential volume of sales: The choice of the channel depends upon the target volume of business. The ability to reach target customers and the volume of sales varies between different channels. One outlet may not be adequate for achieving the target in which case more channels need to be used. Of course, the competitive situation must be taken into account while examining the potential volume of sale through different channels.

8)Cost of distribution: The various functions carried out in the channel of distribution add to the cost of distribution. While choosing a channel, the distribution costs of each channel should be calculated and its impact on the consumer price should be analysed. A channel which is less expensive is normally preferred. Sometimes, a channel which is convenient to the customers is preferred even if it is more expensive. In such cases the choice is based on the convenience of the customers rather than the cost of distribution.

9)Long-run effect on profit: Direct distribution, short channels, and long channels have different implications with regard to the profits in the short-run and long-run. If demand for a product is high, reaching the maximum number of customers through more than one channel may be profitable. But the demand may decline in course of time if competing products appear in the market. It may not be economical then to use long channels. So, while choosing a channel one should keep in mind the future market implications as well.

7.What is insurance? Explain various types of insurance. (2+8)

Ans: Insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join to insure themselves against such an event. For example, it is a common knowledge that every year a certain number of houses are destroyed by fire, but nobody can predict which particular house will be destroyed. Thus, all house owners run the risk of loss through' fire. If all of them pay a small sum into a find every year, anyone who does lose his house can claim money from such fund to build a new house. In the absence of such a fund, the owner of the house has to bear the whole loss by himself. In the case of insurance, in the similar way, loss is being shared by a large number of persons instead of being borne by one. In the above illustration the persons who got their houses insured are known as 'Insured'. The agency which helped them in entering into this arrangement is known as 'Insurer' or the Insurance Company. The agreement or contract between the insurer and insured is known as 'Policy'. The amount paid by the insured in return of which the insurer undertakes to make good the loss is known as 'Premium'. we may define insurance as a form of contract between two parties (insurer and insured) whereby one party (insurer) undertakes in exchange for a fixed amount of money (premium) to pay the other party (insured), a fixed amount of money on the happening of a certain event (death or attaining a certain age in case of life) or to pay the amount of actual loss when it takes place through the risk insured (in case of property).

Various types of insurance are:

1)Life insurance

2)Marine insurance

3)Fire insurance

4)Motor insurance

5)Miscellaneous insurance

1)Life insurance: Life insurance is a contract under which one person, in consideration o fa premium paid (either in lump sum or by monthly, quarterly, half-yearly or yearly payment),undertakes to pay to the person for whose benefit the insurance is made, a certain sum of money either on the death of the person whose life is insured or on the expiry of a specified period of time.Life policies are considered as life assurance policies.The insurer must pay the agreed amount (policy amount) on the occurrence of the agreed event (death or expiry of the specified time).

Types of Life Policies: Some of the types types of life policies are discussed below:

Whole Life Policies: Under this policy, the sum assured is payable after the death of the assured. The premiums on whole life policies may be payable regularly through out the life of the assured, or alternatively they may be payable for a fured period only (say 20 or 30 years). If the premiums are paid throughout the life, it is called 'ordinary life policy'. In the other case when premiums are paid for a limited period, it is called 'limited payment life policy'.

Endowment Life Assurance: Under this policy the insurer undertakes to pay the sum assured either at the end of a specified period or on the death of the assured, whichever is the earlier. 1n case the assured dies before the expiry of specified period (or before attaining the specified age), the sum assured is payable to the legal heirs or nominees. If the insured survives till the policy matures (i.e, expiry of the specified period), the sum assured is paid to the insured himself. The premium for endowment policy is a bit higher than the whole life policy.

Term Assurance: This is also called temporary assurance. Under this policy, the sum assured is paid when the assured dies before the stipulated date. No payment is made if the assured survives to that date. For example, policies of this kind are taken out by persons who travel abroad, to cover short-period bank loans so that the sum assured will be available to repay the loan if the borrower die before the policy lapses, etc.

Joint Life Policy: This type of assurance involves the insurance of two lives simultaneously in the same policy. The sum assured (policy money) is payable by the insurer upon the death of any one of the assured to the surviving person. If both the policy holders die at the same time, their legal heirs or nominees will be paid the assured sum.

Group Insurance: Under group insurance, a group of persons under the same employer are covered under a single policy. Premium is paid by the employer alone or by the employer and employee jointly. A group insurance policy may cover all the employees or a particular category/section of the employee of the same organisation. However, the employees are covered under this policy as long as they serve with that employer. In group insurance, the insurance contract is between the employer and the insurance company (insurer).

2)Marine Insurance: Marine insurance is an arrangement by which the insurer undertakes to compensates the owner of a ship or cargo for complete or partial loss at sea. Marine insurance covers ship, cargo and freight. Perils of the sea also includes any land risk incidental to sea voyage.Under marine insurance, insurable interest must exist only at the time of loss. It is not necessary for the insured to have tlze instrlnble interest at the time of taking the marine insurance policy. Marine insurance is a contract of indemnity.

Types of Marine Policies: The different kinds of marine policies are as follows:

Voyage Policies: This type of policy covers a ship or cargo during a specified voyage only. Thus the limits of the risk are from the port of departure to the port of destination. The risk which is covered starts from the departure of ship fiom the port and it ends when that ship reaches the port of destination.In the case of a voyage policy, issurer is not liable if the destination of the ship is changed or the ship deviates from the agreed route. However, deviation from the agreed route is allowed when it is necessary for the safety of ship/cargo or saving the human life or any other circumstance stated in the contract.

Time Policy: This type of policy covers the risk during a stated period of time irrespective of number of voyages made. This policy would cover all the risks from the perils of sea for a stated period of time.A time policy covers a period not more than 12 months. Most time policies include a contintiation clause providing against expiration of the policy if the ship is still on the voyage. A monthly prorata premium is payable for the continuation.

Mixed Policy: This combines the elements of a time policy and voyage policy. Mixed policy covers the risk during a particular voyage for a specified period.

Valued and Unvalued Policies: Under valued policy, the value of the subject matter insured (ship/cargo) is specified on the face of the policy. In the event of full loss the insurer compensates the amount specified in the policy. If the loss is partial a proportionate amount is paid by the insurer. On the other hand, in the case of an unvalued policy, the value of the subject matter is not stated in the policy. In case of loss or damage, the compensation is ascertained by assessment of loss, subject to the limit of the sum insured.

Floating Policies: This policy is suitable to a merchants who makes regular shipments. To avoid the botheration of taking a separate policy for every shipment, of exporter can take a floating Policy. A floating policy is taken for a round amount, and leaves the details to be declared at a later time, Whenever some cargo is shipped, the shiper (insured) makes a declaration stating the sum for which it is to be insured. Then the total value of the floating policy is reduced by that amount. With each shipment, the value of the policy goes on decreasing.

3)Fire Insurance:Fire policies cover the losses directly caused through fire. However, it is necessary that fire must happen by ignition. If the fire is caused through the

malicious act of the insured himself, he would not be able to recover the loss from the insurer. The fire insurance contract is an indemnity contract.In addition to fire, the standard fire policy covers such perils as lightning, explosion of domestic boilers, gas used for lighting and heating, and damage by water used to extinguish a fire on neighboring property. For a small additional premium the policy may be extended to cover such other items as storm and flood, earthquakes and impact from road vehicles or aircraft, but

not glass and china, jewellery,manuscripts and other items of value, except where specially mentioned.Fire policy is for a fixed period. During that period if there are successive fire accidents, the insurer is liable to make good of all those successive losses.

Types of Fire Policies:

Specific Policy where the liability of the insurer is limited to a specified amount, which is normally less than the actual value of the property insured.

Valued Policy where the insurer agrees to pay a fixed amount in the event of loss, irrespective of the actual loss suffered. Under this policy, the insured recovers a fixed amount, irrespective of the amount of actual damage.

Floating Policy where the amount of the policy may vary from time to time. This type of policy is useful in the case of goods in store where quantity and value change from time to time.

Replacement Policy where the insurer has the option to replace the property/goods damaged by fire, instead of paying the loss by cash.

Loss of Profit Policy where insured is protected against the loss of profit due to dislocation of business due to fire. Under this policy, insurer compensates to the extent of the loss in profits.

Comprehensive Policy which provides cover against not only fire but also several other risks such as lightning, riot, earthquake, flood, storm, burglary, war, etc.

4)Motor Insurance: Owners of motor vehicles (two or four wheelers) can take insurance policies to cover different types of risks viz., (a) loss or damage to the vehicle, (b) injuries to or death of any passenger, and (c) damages payable to the third parties for accidents. Every motor-vehicle driver must be insured for against liability for death of or injury to third parties and for the cost of their medical surgica1 treatment.

5)Miscellaneous Insurance: There are several other types covering various other aspects of risks. Some of them are discussed below:

Engineering Insuranc :This is a highly technical branch of insurance. It is a branch of insurance that has expanded rapidly under recent legislation and especially under the Factories Acts,which prescribe compulsory inspection at regular intervals of certain types of industrial equipment, such as boilers, electrical plant, cranes and other lifting gear.

Aviation Insurance:Under aviation insurance, cover is available for loss of or damage to aircraft,personal accidents to passengers, third party risks in respect of both person and property and for cargo sent by air.