December 2013

ECO-01 Business Organisation

SECTION-A

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

(a) Distinguish between economic and non-economic activities.

Ans: Economic activities refer to the actions of the individuals associated with the manufacturing and consumption of products and services. These are done for monetary gain. All the economic activities have significant characteristics to acquire wealth, earn a livelihood and facilitate economic growth. Activities performed must be lawful and legally binding to gain income. Unlawful activities like theft, smuggling, drug dealing, burglary are not economic activities.

Economic activities performed by the individuals include:

- Producing the goods and services
- Consuming the delivered goods or services
- Distributing the produced goods or services
- Resource management

Non-economic activities are those activities done to offer products or services to others with no purpose of financial gain. Individuals achieve self-satisfaction and no remuneration returns. Other individual sentiments are addressed, and activities are initiated for personal content. Examples of non-economic activities include helping disabled person, homemaker managing daily tasks, cultural and religious activities etc..

Economic activities	Non-economic activities
Activities are done for a living.	Activities are done for personal satisfaction.
Economic growth and development is achieved.	Psychological and social change is achieved.
These activities are done in three sectors- primary, secondary and tertiary.	Activities are based on interests , habits, hobbies; hence no sectors are involved.
Main aim is to earn financial remuneration by providing services.	The main idea includes psychologically and emotionally developing by performing such activities.
Business and employment are the superior outcomes of performing these activities.	Personal satisfaction and social responsibility are achieved by performing non-economic activities.

(b) Explain entrepreneurship and its main characteristics.

Ans: Entrepreneurship is the act of being an entrepreneur. Entrepreneurship is derived from a French word ‘entrepreneur’ which means to undertake, to pursue opportunities, to fulfil needs and wants of people through innovation and starting business. The entrepreneur is the person who does all this. He

undertakes a venture, organises it, raises capital to finance it and assumes the whole or major part of the risk of business. Thus, 'entrepreneurship is the process of giving birth to a new business'.

Characteristics of an Entrepreneur are:

i. Independence: Many entrepreneurs who started their businesses resisted being pigeonholed or following routine habits. In fact, entrepreneurs become frustrated when they have to follow someone else's direction. They have to be the boss. They like to be in control. They find it difficult to work under the direction of others.

ii. Hard Work: Willingness to work-and work hard-is an outstanding trait of entrepreneurs. A successful entrepreneur described his early experiences that they worked endless, twelve hour days and sometimes seven days a week.

iii. Desire-to Achieve Goals: They have a strong desire to overcome problems and setting up successful business ventures which eventually give adequate profits. They considered profit as measure of their achievement and performance rather than making money alone.

iv. Foresight arid Dynamic Outlook: Basically, these people have wide knowledge about business environment i.e., market, consumer attitude, technological development, etc. Further, they ore dynamic in forecasting business uncertainties and risks, accordingly, they take quick and sound decisions.

v. Open-mindedness: They are intelligent in predicting changes in business environment. However, they never resist changes because they know that they cannot stop it. Therefore, they are habituated to open-mindedness even though sometimes they lose crores of' rupees due to changes in consumer tastes which ultimately forced them to change their technology, etc.

vi. Optimistic Outlook: They are generally inclined to believe that present problems are of it temporary nature and conditions will be more favourable in due course. Entrepreneurs are always eager to achieve their goals in the best possible manner, to get outstanding results which they can be proud of.

vii. Working Relationship : The success of a business mostly depends upon its workers first rind then their links with other business undertakings. Most of the successful business entrepreneurs have had harmonious relationships with others. This builds up their reputation in the market.

viii. Good Organisers : They are good at bringing together different types of resources needed for starting a business and making it operationally efficient. They can convince people about the prospects of business, get their cooperation, raise funds, procure machinery, arrange supply of materials, select right type of employees and coordinate various activities relating to the business.

ix. Innovative Aptitude: Most of the successful entrepreneurs have innovative aptitude. They spend part of their income on research and innovative activities so that they offer suitable products to meet the demands of consumers. Some of our industrialists like Tata, Birla, Kirloskar, etc. have established their own research centres.

(c) What do you mean by public deposits ? State the conditions to be satisfied if a small scale unit wants to exceed the limits.

Ans: Companies often find it convenient and necessary to raise funds by inviting their . shareholders, employees and the geqeral public to deposit their savings with the company. The Companies Act

permits such deposits to be received for a period up to 3 years at a time. Thus, public deposits can be raised by companies to meet their short-term and medium-term financial needs. It is a simple method of raising finance for which the company has only to advertise in the newspapers giving particulars about its financial position as prescribed by the Companies Act. The deposits are not required to be covered by mortgaging assets or by other securities. Moreover deposits can be invited by offering a higher rate of interest than the interest on bank deposits.

However, small scale industries (i.e. manufacturing companies with investment in plant and machinery not exceeding Rs. 35 lakhs) are exempted from the restrictions as to the maximum limit of deposits if the following conditions are satisfied.

ij The amount of deposit does not exceed Rs. 8 lakhs or the amount of paid up capital whichever is less.
ii) The paid up capital does not exceed Rs. 12 lakhs.

iii) The number of depositors is not more than 50%.

iv) There is no invitation to the public for deposits.

(d) What is meant by margin trading ? Explain with an example.

Ans: It refers to the practice of buying and selling securities by depositing with the broker a certain percentage of the value of the securities involved in the transaction. The percentage of value so deposited is called 'Margin Money' or 'Margin'. The objective is to meet the loss, if any, out of this deposit. When the margin money is deposited, the broker credits the Margin Account of the customer. Deposit of margin money is a precondition for the securities to be held on account of the client. Where the margin falls short of the amount of loss suffered by the client on the securities held in his account, the broker may ask the client to deposit additional amount to cover the shortfall. In case he does not deposit such amount, the broker can sell the securities and recover the amount.

(e) Explain publicity and its different forms.

Ans: 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.

Publicity may be favourable or unfavourable to the company. When the publicity favourably reports about a product, it can positively influence the demand, for that product. On the other hand, unfavourable publicity may lead to reduced sale of the product.

You may have read film reviews in magazines or newspapers. These reviews are written by the magazine or newspaper staff. The producer of the film is in no way connected with it. In these reviews, there are comments on the story, music, photography. performance of main artists, etc. These reviews count as publicity. If the comments in the review are not good, the readers have a qegative impression about the film and they are not eager to see the film. This is an example of unfavourable publicity. If the comments

are good in the review, there is a positive impression about the film in the mind of th6: reader and many of them will see it. If is an example of favourable publicity.

(f) State the services of wholesalers to the retailers.

Ans: Retail traders are benefited by the services of wholesalers to a greater extent than the manufacturers. The more important of the services to retailers are as follows:

1. A variety of goods can be procured by retailers in small quantities from the wholesalers. Most retailers serve a large number of customers. Thus different types of products have to.be stored by a retailer to meet the needs of individual consumers. It is difficult for him to buy the products from different manufacturers in small quantities. He can easily do so by contacting a few wholesalers.

2. Small retailers can get repeated supplies of products from wholesalers. Thus they are able to run their business with a relatively small amount of capital. Large stocks are not to be held by them, so there is saving of storage space as well.

3. Wholesalers have expert knowledge of the lines of products they deal with. They procure the items from the best sources, that is from producers who supply the best I quality at competitive prices. Retailers also get advantage of the wholesalers' specialised knowledge of the products.

4. Retailers are protected from the risk of loss which would arise if they were to hold large stocks of any product. It is the wholesalers who bear the maximum business risks arising out of falling demand for products.

5.Most wholesalers supply goods on credit to the retailers. This enables small retailers to pay for the goods after sale or customer payment on account. The working capital required for retail trading is thus relatively small.

6.Generally retailers come to know about new products or items of trade only through the wholesalers who deal with manufacturers. Whenever any new product is introduced, wholesalers bring it to the notice of retailers either through salesmen or display in showrooms.

(g) What do you mean by mortgage ? Explain its importance in business.

Ans: When immovable property like land and building is offered as security for debt, a charge is I created thereon by means of a mortgage. A mortgage is the transfer of the interest in a specific immovable property by one person to another for the purpose of securing an advance of money. The transferor is called 'mortgagor' and the transferee is known as 'mortgagee'. The advance of money in respect of which the mortgage is effected is called the ‘mortgage money' and the instrument by which the mortgage is effected is called the 'mortgage deed'. In a mortgage, the possession of the property need not always be transferred to the mortgagee. Usually, it remains with the mortgagor. Since the mortgagee gets the interest in the property, he has a right to sell of the property and recover his loan. When the borrower ' repays the amount of loan together with interest, the interest in the property is re-conveyed to the mortgagor. While accepting a mortgage as a charge, the bank should ensure that the borrower has a valid title to the property and this can be done by examining the original title deeds. The bank must not part with the title deeds to the borrower when the mortgage is pending. If the advance against mortgage is given to a joint stock company, then the charge should be registered with the Registrar of Companies within 30 days of the creation of the charge. The mortgaged property should be

inspected periodically to ensure that it is in good condition. If the property mortgaged is building, the bank should ensure that it is insured against fire, riot etc. There are several forms of mortgage. They are (i) simple mortgage; (ii) Usufructuary mortgage; (iii) English mortgage; (iv) Mortgage by conditional sale; (v) Equitable mortgage or mortgage by deposit of title deeds and (vi) anomalous mortgage.

(h) Enumerate the salient features of the public enterprises.

Ans: Government owned enterprises are also called Public Enterprises (PEs). Public enterprise, as a business entity, refers to any industrial or commercial undertaking which is owned and managed by the central, state or local government and of which the output is marketed i.e., not supplied free. Thus, public enterprises include manufacturing, trading as well as service organisations which are essentially business undertakings. Public enterprises consist of nationalised private organisations as well as new enterprises promoted under government ownership and control. Life Insurance Corporation, Indian Airlines Corporation, Coal India Ltd., etc., are examples of public enterprises established by nationalising private organisations. Hindustan Machine Tools, Hindustan Antibiotics Ltd., Chittaranjan Locomotive Works, etc., are examples of public enterprises promoted by government.

Features of Public Enterprises are:

i) Public enterprises are owned and managed by the government or agencies set up by the government.
ii) The whole or major part of the capital required for the public enterprises is provided by government.
iii) These are governed by public policies laid down by the government in the public interest and are not entirely guided by profit motive.

2. What is meant by trade ? Describe briefly different aids to trade. 2+8

Ans: Trade, as a business activity involves buying goods from producers and selling the same to consumers. In other words, those who are engaged in trade need to procure goods produced or manufactured at particular places and supply them to customers in different places.

Activities which facilitate the trade are called 'aids to trade'. Thus, all human activities which eliminate the hindrances and facilitate the flow of goods from producers to consumers come under aids to trade. They are also called 'auxiliaries to trade'. The whole range of activities coming under aids to trade may be classified into five categories: 1) transportation, 2) warehousing, 3) insurance, 4) advertising, and 5) banking.

1)Transportation: All the goods are not consumed at the same place where they are produced. In the modern times there is a vast distance between centers of production and the centers of consumption. Therefore, goods are to be moved from the place of production to the place where they are demanded. This difficulty is removed by an important aid to trade known as transport. Thus, transportation eliminates the hindrance of place and creates place utility to goods. Transportation can be of three types: a) Land transportation - road, rail b) Air transportation-aeroplane C) Water transportation-boat, ship

2) Warehousing: Warehousing is an act of carefully storing goods in warehouses to sell or distribute them later. Warehousing is essential because there is a time gap between production and consumption. In other words, goods which are produced at one time, are not consumed at the same time. Hence, it becomes necessary to make arrangements for storage or warehousing. Goods once produced should be

preserved properly till they are consumed. Particularly, perishable goods like milk, meat, vegetables, flowers, etc., should be preserved very carefully. Otherwise, they get spoiled and become useless. For this reason warehousing is recognised as yet another aid to trade. Thus, warehousing eliminates the hindrance of time and provides time utility to goods.

3) Insurance: The goods may be destroyed while in production process, or in transit due to accidents, or in storage due to fire or theft, etc. The businessmen would like to cover thcse risks. Insurance companies come to their rescue in this regard. They undertake to compensate the loss suffered due to such risks. For this purpose, the business has to take an 'insurance policy' and pay a certain amount regularly, called 'premium'. Thus, insurance eliminates the hindrance of risk.

4) Advertising: Exchange of goods is possible only when the consumers have the knowledge about the existence of a product. This is the hindrance of knowledge. This hindrance is eliminated through advertising. Through advertisement, producers communicate all information about their goods to the prospective consumers and create in them a strong desire to buy the product. Thus, advertising facilitates the flow of goods between producers and consumers by bringing the knowledge about the products to the consumers. Advertising is done through TV, radio, newspapers, magazines, hoardings, wallposters, etc.

5) Banking: Banking solves the problem of finance. Banking facilitates the flaw of goods by removing the hindrance of finance and credit. Businessmen receive money and pays money in large amounts. It is risky to carry a large amount of cash from one place to another. Here comes banking as a solution. Banking and financial institutions solve the problem of payment and facilitate a smooth exchange between buyer and seller. The businessmen may also require short-term and long-term funds. Bank provide such finance to businessmen. Banks also advance loans in the form of overdraft, cash-credit and discounting of bills of exchange etc.

3. Explain the cooperative form of business organisation and state its merits and limitations. 2+4+4

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.

A cooperative society 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.

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. 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.

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 exemptions.

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.

4. Describe the methods of raising long-term capital for a company. 10

Ans: Long-term capital may be raised by companies from, one or more of the following sources:

i) Capital market which consists of individual investors, financial institutions and investment companies
ii) Special financial institutions consisting of development banks and institutional ' investors.'

iii)Leasing companies

iv)Foreign sources

v)Retained profits

i) Capital market: Transactions involving procurement of funds and supply of funds which take place among individuals and various organisations may be regarded as the capital market. Thus, the capital market is not located in a particular place. There are no fixed categories of investors and dealers in the market. Another type of market in connection with business finance, known as the money market. Money market refers to transactions involving borrowing and lending of money for short periods for which again there is no definite place set aside in a town.

ii) Special financial institutions: After independence many financial institutions have been established in India with the primary objective to provide medium and long-term financial assistance to industrial enterprises. Institutions like Industrial Finance Corporation of India (IFCIs), Industrial Reconstruction Bank of India, State Financial Corporation (SFCs), State Industrial Development Corporation (SIDCs), have been established to provide financial support to set up new enterprises as well expansion and modernisation of the existing enterprises. On the other hand, at the state level there are State Financial Corporations (SFCs) and Industrial Development Corporations (SIDCs). These state level institutions mainly provide long-term finance to relatively smaller companies. These institutions (both national level and state level) are known as 'Development Banks' because their main objective is to provide financial assistance to industrial enterprises for investment projects, expansion or modernisation of plants in accordance with the priorities laid down in the Five Year Plans.

Besides the development banks, there are several other institutions known as investment companies or investment trusts which subscribe to the shares and debentures offered to the public by companies. For example, the Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC), the Unit Trust of India (UTI), etc., come under this category.

iii) Manufacturing companies can secure long-term funds from leasing companies. For this purpose, a lease agreement is made whereby plant and machinery and fixed assets may be purchased by the leasing company and allowed to be used by the manufacturing concern for a specified period on payment of an annual rental. At the end of the period the manufacturing company (lessee) may have the option of purchasing the asset at a reduced price. The ownership of the asset remains with the leasing company (lessor) during the lease period. To meet its financial requirements, a manufacturing company may also sell its existing fixed assets to a leasing company at the current market price on the condition that the leasing company would lease the assets back to the seller for a specified period. Such an arrangement is known as 'sale and lease back'. The manufacturing company in this case gets the immediately without having to part with the physical possession of the assets. It continues to use the assets on payment of periodical rent for the lease.

iv)Foreign sources: Funds can also be collected from foreign sources which usually consist of: a) foreign collaborator, b) international financial institutions, and c) non-resident Indians (NRIs)

a) Foreign Collaborators: If approved by the Government of India, large companies may be able to secure long term finance based on collaboration agreements with companies abroad. Foreign collaboration may, thus, enable Indian companies to secure equity capital from abroad through the

subscription of foreign collaborator to their share capital, or by way of supply of technical knowledge, patents, drawings and designs of plants or supply of machinery.

International Financial Institutions: There are several international financial institutions which provide long-term funds for industrial development all over the world. The most important among them are: i) The World Bank, and ii) International Finance Corporation.

The World Bank grants loans for specific industrial projects of high priority included in the national development plan. The loans must be guaranteed by the Government of India, and may be given directly to an industrial concern, or through a Government agency, or may be given to the IOBI for refinancing to companies.

b) The International Finance Corporation (IFC) was established in 1956. It is an affiliate of the World Bank. As you know the World Bank grants loans only to governments of member-countries or private enterprises with guarantee of the concerned government and it does not provide risk capital to enterprises in member-countries. s. IFC was set up to assist the private undertakings without the guarantee of the member-countries. It also provides them risk capital. IFC grants loans to industrial firms for a period of 8 to 10 years. Such loans do not require Government guarantee.

c)Non-resident Indians: Persons of Indian origin and nationality living abroad (Non-resident Indians) are also permitted to subscribe to the shares and debentures issued by companies in India. A non-resident or a company controlled by a non-resident can invest up to a maximum of 5% of the paid-up equity capital of an Indian company.

v)Retained profits: An important source of long-term finance for ongoing profitable companies is the amount of profit which is accumulated as general reserve from year to year. To the extent profits are not distributed as dividend to the shareholders, the retained can be reinvested for expansion or diversification of business activities. It be used for renovation of assets or modernisation of plant and equipment. It may be interpreted that the existing shareholders provide the finance. Hence, the company must decide to reinvest profits only when the rate of return is comparable with that of other similar companies. A part of the profits must be distributed as dividend keeping in mind shareholders expectation and the effect of dividend rate on the market price of shares. Retained profit is an internal source of finance. Hence it does not involve any cost of floatation which has to be incurred to raise finance from external sources. Further, the company does not have to face the uncertainties of external financing. The only drawback of this source of long-term finance is that it depends on the availability of adequate profits for retention.

5. What is the importance of channel of distribution in business ? Briefly explain the channels of distribution used for consumer goods. 5+5

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. The term 'Channel of Distribution' refers to the route taken by goods as they flow from the producer to the consumer. This flow of goods may mean its physical distribution and/or the transfer of title (ownership). Channel of

distribution is mainly concerned with the transfer of title to a product which may be effected directly or through a chain of intermediaries. You know most producers do not sell goods directly to the consumer. They make use of a variety of intermediaries known as middlemen. These middlemen who take title to goods or assist in transferring the title to goods as they move, from the producer to the consumer are called the channel of distribution.

The functions performed by channel of distribution may be grouped into three categories as follows:

1. Transactional Functions

2. Logistical Functions

3. Facilitating Functions

1. Transactional Functions: Functions necessary to a transaction of the goods are called transactional functions. Buying, and risk bearing functions come under this category. Participants in the channel of distribution undertake these three functions. Producers sell the goods and intermediaries buy them. Later intermediaries sell the goods and consumers buy them. Because of this buying and selling by the channel participants, title to goods change hands and goods flow from producer to consumer. If there is no willingness for buying and selling, there would be no kansaction. When goods are bought, it involves risk also. For instance, an intermediary bought goods from the producer with the intention of selling at a profit. But he incurred loss due to fall in price. All the participants in the distribution channel assume such risk of loss.

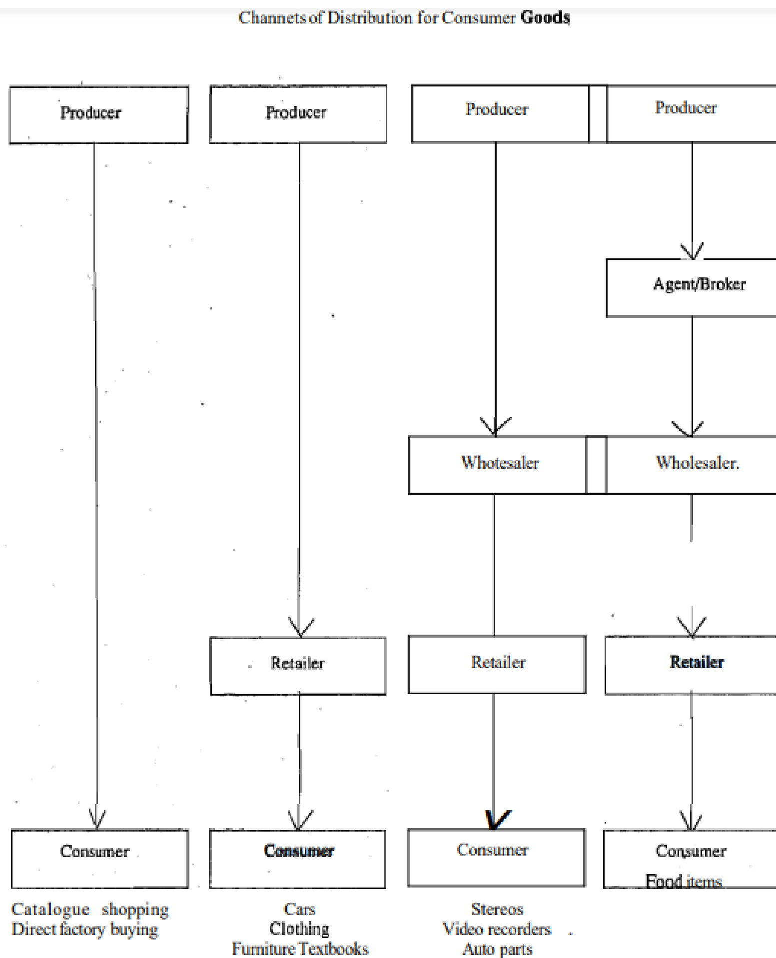
2. Logistical functions: The functions involved in the physical exchange of goods are called logistical functions. Distribution channel performs some functions like assembling, storage, grading and transportation which are essential for physical exchange of goods. Goods are assembled in sufficient quantity to constitute an efficient selling and shipping quantity. Sometimes, it is also necessary to assemble a variety of goods to provide an assortment of items desired by buyers. Grading and packing of goods facilitate handling and sale of goods promptly. Proper storage of goods prevents loss or damage as well as helps regular supply of goods to consumers whenever they want. Transportation makes goods available at the place at which the buyers are located. In the channel of distribution all these functions are performed so that various types of goods may reach the market place at proper time and may be conveniently sold to the ultimate consumers.

3. Facilitating functions: These functions facilitate both the transaction as well as physical exchange of goods. These facilitating functions of the channel include post purchase service and maintenance, financing, market information, etc. Sellers provide necessary information to buyers in addition to aftersales services and financial assistance in the form of sale on credit. Similarly, traders are often guided by producers to help them in selling goods, while the traders also inform producers about the customers opinion about the products. Thus, the channel of distribution performs a variety of functions such as buying, selling, risk bearing, assembling, storage, grading, transportation, post purchase service and maintenance, financing, market information, etc.

Channels of distribution used for consumer goods:

The goods which are consumed by the household consumers are called consumer goods. Under this category you can find a very wide range of items such as food items, stationery, cars, clothing, shoes,

household electrical appliances, TV sets, transistors, etc. The channel of distribution used for different product is not the same. The below figure gives the idea about the channels of distribution for some of the consumer goods.



Sometimes consumers go directly to the factory and buy the goods or , order the goods from the catalogue. Durable consumer goods like cars, clothing, furniture, textbooks, shoes, etc., are generally distributed through retailer. In many cases showrooms are established by the manufacturer himself which undertake the retail trade. For example, Bata Shoe Company sells shoes through its showrooms. Consumer goods like auto spare parts, stereos, video recorder, etc., are distributed through wholesalers and retailers. Consumer goods of daily need like foodgrains, sugar, salt, edible oil, soap, paper, pencils, etc., are generally distributed through agent or broker, wholesaler and retailer.

6. How does foreign trade help economic development of a country ? State its inherent problems. 5+5

Ans: Importance of foreign trade in economic development of a country:

i) Specialisation and efficiency of production: Foreign trade leads to specialisaiton in productive activities undertaken by different countries. Depending on available natural resources, and development of science and technology, every country can produce only those goods and services for which it has the greatest relative advantage and efficiency. No country has facility and resources within its own boundaries for economical production of all its requirements: Some countries are more suitably placed

to produce certain goods/services economically and sufficiently than other countries. Therefore, they can specialise in the production of such goods and get the goods they need in exchange for those goods, For example, India has comparatively greater advantages for the production of agrobased products such as coffee, tea, sugar, textiles, etc. Similarly some developed countries such as USA, Japan, Britain, etc. have greater advantages for the production of industrial machinery, automobiles etc. Some gulf countries such as Iran, Libya, Iraq, Saudi Arabia, etc. produce crude oil, petroleum, etc., in abundance.

ii) Facilitates economic development: Rapid economic development and growth of national income can be facilitated on the basis of exports and imports. Indeed, it is on the basis of imports of raw materials and export of manufactured goods that countries like U.K., Japan etc., have achieved a high rate of economic growth.

iii) Equalisation of prices: International trade equalises prices of goods throughout the world. Whenever the prices of commodities tend to rise in a country, it can increase the level, of its imports to check the rise in prices. Similarly, whenever prices of products decline, the trend may be counteracted by exporting the same.

iv) Employment opportunities: Foreign trade facilitates the growth of agricultural as well as industrial activities which in turn generates more employment in the country.

v) Harmonious relationship between countries: Because of foreign trade every country may have access to goods that it does not produce at home. Similarly, a country with a surplus of certain goods can make them available to other countries experiencing shortage of those goods. This promotes harmonious and cordial relationship among various countries.

vi) Utilisation of resources: Every country possesses some natural resources. The economic development of a country heavily depends upon exploitation of these resources. For example, India has adequate offshore oil resources. But, it requires exploitation through sophisticated machines, technology, etc. which we do not h8ve. Machinery and technology can be imported from the developed countries like USSR, USA, Japan, etc. This leads to best possible use of natural resources.

The problems of foreign trade are:

i) Suitability of the product for the market: Securing information about the suitability of products in the foreign market is a challenging task for every international marketer. This involves heavy expenditure and requires special skill and knowledge. Besides, the quality and price of goods must be more attractive as compared with similar products manufactured abroad. This requires intensive market research on the potential sale of goods to be exported.

ii) Changes in supply and demand conditions: International markets are often subject to changes in the supply and demand for particular products due to the entry of new competitors, or increased competition of local producers, or because of changes in buyers preferences. These changes cannot be easily anticipated by the exporters.

iii) Frequent price changes : The price of products in the international market may be affected by different factors. The changes may be due to changes in exchange rates of the currencies of importing and exporting countries, higher import duties, or freight rates. These factors increase the risks of foreign trade a great deal.

iv) Credit risk: International trade which is generally on a large scale involves heavy amounts to be paid by the importer. The exporters often sell their products on credit and therefore have to bear the credit risk arising from the buyer's default, bankruptcy, etc.

v) Changes in exchange rate: An additional risk of foreign trade is the risk of changes in exchange rates. The rate at which the currency of importing countries can be converted into the currency of exporter may cause losses to the exporter or the importer.

vi) Time gap: The distance involved is usually greater in transporting goods from one country to another country, and hence the transit time is longer. This time gap involves exporter's capital being locked up over a long period.

7. Describe the various steps involved in risk management in business. 10

Risk management involves five basic steps:

i) Risk identification is the first step and also the most difficult function. Failure to identify all the loss exposers of the firm means you will not be in a position to deal with those risks.

ii) After identifying the risks, next step is to assess the intensity of financial loss associated with each of those risks. We have to determine two aspects: I) probability of the occurrence of each of the perils or risk identified in the first stage, and II) extent of financial loss to the firm, if that peril occur. With this assessment, we can identify the relatively more serious risks and pay more attention to them.

iii) Third step is to decide on various tools of risk management and decide upon the best combination of the tools to be used. There are six tools for risk management :

I)assumption(or retension)

II) loss prevention

III)avoidance

IV)transfer(insurance)

V)separation

VI)combination

I) Risk assumption or retention: This is a common way of handling risks. Business enterprises assume or retain risks consciously (intentionally) or unconsciously (unintentionally). Under conscious assumption, one is aware of the risk to which his/her business is exposed, but essentially does nothing to avoid I I it. A manager of a business who consciously assumes risk is doing something about it by the very act of being aware of those perils and hazards which may cause loss. Being aware of risk, he may knowingly or unknowingly make adjustments in operations which will help to alleviate the impact of that risk. Awareness of risk itself is a significant achievement in better management. In the case of unconscious risk assumption, risk is not recognised. As you are not even aware of the existence of some risk, losses stemming from it can cause disastrous surprises to your business.

II) Loss Prevention: Another method of handling risk is to take appropriate measures to prevent the occurrence of a peril or minimise its financial impact on business. This approach is known as loss

prevention. For example, by using fire resistant building material, you can prevent the occurrence of fire in the building. Loss prevention may not totally eliminate the risk, but can reduce its probability in terms of frequency as well as severity.

III) Avoidance: Avoiding situations which have the potential to cause loss, is another approach. For instance, a firm can avoid the risk of loss due to bad debts by simply stopping credit sales.

IV) Transfer: Transferring the risk to another party is a very widely followed approach to handle risks. Insurance is the most common method of transferring pure risks such as fire, windstorm, flood, riot, theft, etc. Business enterprises normally transfer the pure risks to the insurance company and devote their full efforts to their normal business.

V) Separation: Fifth method of risk control is separation of the firm's exposers to loss instead of concentrating them at one location where all of them might be involved in the same loss. For example, when a firm keeps its entire raw material in one warehouse, the entire raw material may be damaged if fire occur in that warehouse. Therefore, the firm may decide to store the raw material in ten separate warehouses. If fire occur in one warehouse, materials stored in that warehouse are damaged and the remaining nine warehouses are safe. This methods is also a kind of loss prevention.

VI) Combination: Strategies like diversification of products, law of large numbers, formation of more companies with unrelated lines of business, etc., come under this method. For example, if a firm is engaged in more products, the losses incurred in one product may be upset by the gains in another product. Similarly, if there are more companies, the losses incurred by one company may be upset by the gains by the other companies. Insurance companies work on this combination principle where a sufficiently large number of similar objects are combined to make the loss predictable within narrow limits.

While managing risks, one need not just rely on any one method, instead may rely on some combination of various methods.

iv)After taking a decision regarding the combination of risk management tools, the next step is the implementation of the decision made. For instance, if you have decided in the previous stage to transfer the risk, you have to get the insurance policy at this stage.

v) Last step is to evaluate the effectiveness of the risk management tools we have implemented.

The result of the decisions made in the four stages must be evaluated to determine their effectiveness and change the strategy, if required.