

December 2017

ECO-01 Business Organisation

Part A

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

(a) Briefly explain the advantages of raising funds through the issue of debentures.

Ans: Companies generally have powers to borrow and raise loans by issuing debentures as securities of specified face value. The rate of interest payable on debentures is fixed at the time of issue, and they are recovered by a charge on the property or assets of the company, which provide the necessary security for payment. Debentures are mostly issued to finance the long -term requirements of business. There are certain advantages of issuing debentures:

- i) Because of the fixed interest on debentures, companies with stable income can secure higher returns on equity capital by trading on equity.
- ii) The rate of interest is usually lower than the expected rate of return on share 14 capital. This is because debenture holders do not bear any risk.
- iii) Debentures do not carry any voting right. Hence management by promoters or existing directors remains unaffected.

However, if the earnings of the company are uncertain or unpredictable, issue of debentures may pose serious problems for the company due to the fixed obligation to pay interest and repay the principal. . The company is liable to pay interest even if there is no profit. If there is default in payment of interest or repayment of the principal, assets can be attached by order of the court. Trading companies which generally do not have large fixed assets, cannot provide adequate security for issue of debentures. Even for manufacturing companies the capacity to raise loans is limited by the value of their properties and assets.

(b) Differentiate between business and profession.

Ans:

Business	Profession
Business is an economic activity concerned with the production or purchase and sale of merchandise and rendering of services with the purpose of earning profit.	Profession is a form of economic activities, wherein special skills, knowledge and expertise is required to be applied by the person, in his occupation.
The primary objective of a business is to earn profit	Profession is aimed at providing services.
A business can be established by the decision of the entrepreneur and fulfilling certain legal formalities.	Profession requires membership of the respective professional body and certificate of practice, for the establishment.
Any person can start a business, there is no minimum qualification to run a venture.	Specialised knowledge of study, training and expertise is the major requirement for the profession.

It requires capital investment according to its size and nature.	Capital requirement is limited. Some amount of capital required for equipment and establishment of office.
Gets profit as a return for the work done by him/her.	Professional gets a fee for the services rendered by him/her.
Transfer of interest is common. By following required legal formalities, business can be transferred to others.	Transferability is not possible as it requires specialised skill and knowledge.
Risk factor is always present in business. There is risk of loss.	Risk factor may or may not be present in a profession. Possibility of not getting enough fee to meet the expenditure on establishment
Every business advertises its products and services, for the purpose of increasing sales.	Advertisement is strictly prohibited as per professional code of conduct.

(c) Explain the concept of 'entrepreneurship'.

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'.

Innovation and risk bearing are the two basic elements of entrepreneurship.

Innovation: If a business activity does not require anything special to be done, it is not entrepreneurship. In fact a person cannot be called an entrepreneur unless he introduces something new, something different, in his venture. This is known as innovation, that is, doing something different from others. In a competitive market, an entrepreneur can succeed in his business only through innovation. An innovation need not necessarily be something big or dramatic. A simple adjustment to something old, or giving a service without extra charge while selling a product, or a colourful packaging, or selling a product in packets of different weights, and such types of steps may be profitable innovations. An entrepreneur must have imagination and also the ability to think creatively.

Risk Bearing: Risk bearing is another aspect of entrepreneurship that every entrepreneur has to cope with. One who is an entrepreneur must be a risk taker, not a risk-avoider. In fact, starting a new business always involves risk because money is invested for profits in future. To try anything new is also risky. A new venture may not bring the expected profits or may fail and run into losses. It may happen because of increasing competition, a change in customer preferences, shortage of raw material supply, or sudden unexpected calamities. But an entrepreneur is bold enough to assume the risks. He is prepared to take risks for the reward.

(d) Write a short note on 'Recurring Deposit Account'.

Ans: Recurring Deposit Account: Recurring deposit accounts are meant for people who have regular monthly incomes. This type of account is intended to encourage the habit of savings among depositors on a regular basis. In this account, the depositor deposits a fixed sum of money every month for an agreed period and at the end of the specified period, he gets back the amount deposited together with

the interest accrued thereon. The period for which a recurring account is opened varies from one year to ten years. The rate of interest is higher than in a savings bank account. The pass book is to be presented to the bank every month when a deposit is made, so as to enable the bank to record the deposit therein.

If a depositor is in need of money before the due date, the bank can on his discretion, repay the amount. Generally, instead of repaying the deposit amount, the bank grant a loan to the depositor against the security of his recurring deposit account. The bank charges interest on such loan at a rate which is one per cent. higher than the rate of interest applicable to the particular recurring deposit.

(e) What are the essentials of a good transport system ?

Ans: A good transport system is one which should serve the purpose of transportation and satisfy the following requirements:

1. It should be economical. The cost of transport service should be low enough to enable the users to carry their goods at the lowest possible charge so that the ultimate consumer get the products at a reasonable price.
2. It should be capable of carrying goods as speedily as possible. There should not be any delay in reaching the destination except for natural calamities or unavoidable causes.
3. The transport service should be available regularly as and when required. It must ensure the safety of the goods.
4. It should be operated by the properly skilled and efficient persons capable of handling problems in emergency.
5. It should provide for ensuring the risks of loss or damage to goods in transit, and assure payment of due compensation in case of delay causing loss to the owner of goods.
6. There should be proper arrangements for loading and unloading of goods promptly and at minimum cost.
7. As far as possible, delivery of goods should be made at locations convenient to the receiver of the goods.

(f) State the objectives of Public Enterprises.

Ans: The objectives of Public Enterprises are:

- i) To achieve rapid economic development through industrial growth in accordance with the development plans.
- ii) To channelise resources in the best possible manners for economic growth.
- iii) To secure public welfare and to reduce inequalities' in the distribution of income and wealth.
- iv) To ensure balanced regional development of industry and trade.
- v) To prevent the growth of monopoly and concentration of economic power in a few private hands.

- vi) To control the prices of essential consumer goods in the market to prevent public hardship.
- vii) To mobilise public savings through financial institutions to meet the demands of public and private enterprises in accordance with planned priorities.
- viii) To provide satisfactory employment conditions to the personnel as model employers.

PART – B

Attempt any three of the following questions:

2. What do you mean by 'business risk'? Explain the process of risk management. (3+7)

Ans: The term is used to refer to (a) an insured object such as a home or a car, (b) a peril such as fire or earthquake, (c) the probability of an event which may cause loss, (d) the loss itself, (e) the hazardous condition, (f) the variation in the outcome that could such as fire or earthquake, (c) the probability of an event which may cause loss, (d) the loss itself, (e) the hazardous condition, (f) the variation in the outcome that could occur over a specified period in a given situation, etc. 'Business risk' may be defined as the uncertainty of occurrence of economic loss in the event of any business activity.

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 expositors 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 retention)

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 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 exposures to loss instead of concentrating them at one location where all of them might be involved in the same loss.

VI) 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 method is also a kind of loss prevention.

VII) 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.

3. What is meant by Public Utility Undertaking? Discuss the broad aspects of their pricing policies. (2+8)

Ans: In our day-to-day life, directly or indirectly, we require a number of essential services. In the cities you have tap-water. Similarly various means of transport help you in undertaking your journey everyday. You need electricity for lighting, air-conditioning, etc. Electricity is also used for running Factories, trams, railways, irrigating crops, etc. All these services are called public utility services and the organisations which provide these services are known as public utility undertakings.

All the public utility undertakings have an obligation to supply the essential goods and services to everyone in the community without any discrimination at reasonable prices.

Public utilities are distinct from other commercial undertakings. They are endowed with certain characteristics. They are: 1) indispensability of product or service, 2) restricted area of operation, 3) monopolistic or semi-monopolistic position, 4) regulation and control by government, 5) franchise, 6) huge capital investment, 7) inelastic demand, 8) non-transferability of supply by the consumer, 9) lower risk, and 10) limited choice of size and of site.

Public utility undertakings are subject to government regulation and control since they deal in products and services essential to the public. The objective of government regulation is to ensure quality of service and uninterrupted supply at a reasonable price.

These undertakings need not necessarily advertise their products or services. Problems of credit collection do not arise in the case of public utilities. The products or services of some public utilities are sold on cash basis. Therefore, these undertakings do not suffer much loss on account of bad debts.

Broad aspects of their pricing policies:

Price of a commodity is usually determined by two factors: 1) demand, and 2) supply. This does not apply in the case of all goods and services supplied by the public utility undertakings. There are other considerations which play a more important role in fixing the price. In the case of public utility concerns, price is not fixed on the basis of cost involved in the production or supply of such services i.e. cost of service principle. It is determined on the basis of the purchasing capacity of the consumers, which is called the principle of what the traffic will bear.

The goods and services provided by public utility concerns are essential services or goods. These products or services are used by the poor and the rich alike. The rich can pay higher price to avail of these services, while the poor may not be able to pay for it if prices are fixed on cost basis. Hence the government takes care of and safeguards the interests of the poor by regulating the prices of such goods and services so that the poorer people may also be able to use them. Consumer will pay a fair price. Determination of a fair price involves a number of considerations like cost of production, cost of supply, a reasonable rate of profit, paying capacity of the customers, changes in the general price level, and so on. Thus, price determination is not a simple matter. It is to be determined after due consideration and consultation with various interests. However, the following three broad aspects of the price policy of public utility undertakings can be kept in mind.

i) Promotional aspect: This aspect is concerned with the promotion of demand of the services provided by the public utility undertakings. Promotional aspect refers to increasing demand for the products or

services. Promotion of demand is necessary to ensure full utilisation of the production capacity of the undertaking. This helps in spreading the overhead costs over large output. For example, transport services such as roadways and railways issue monthly tickets (Season tickets) as a concessional rate to a large number of regular passengers.

ii) Price discrimination: The demand for the products of a public utility undertaking is elastic in some markets and inelastic in other markets. For example, in the case of transport services, general public or tourists demand for bus service is elastic (they do not solely depend on public buses, they may also hire auto or taxi). The demand for bus among regular office-goers or students is inelastic (they mainly depend on public buses only). Here the undertakings have to charge less from the students and officegoers, and more from the tourists and the general public. In some cases, public utilities can demand lower price in one market and higher price in others, or may charge lower price from one category of consumers and higher price from the other category of consumer.

iii) Social considerations: Some of the public utility undertakings touch everyday life of the people and are "affected with public interests". In such cases the price of the product is not fixed purely on economic basis. Considerations of social welfare play an important role in the price fixation, Consumers with low incomes or poor people get the services at concessional or subsidised rates.

4. What is a stock exchange ? Explain the factors affecting the prices at a stock exchange. (3+7)

Ans: Stock exchange can be broken into two words- one is 'Stock' which means a part or fraction of the capital of a company, and the other is 'Exchange' which means a market for purchasing and selling. Stock exchange can be defined 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'.

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. 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.

Characteristics of stock exchange are:

1. Stock exchange is an organised market.
2. Securities (shares, debentures, bonds, etc.) issued by central, state and local governments, municipalities, port trusts, public utility concerns, joint stock companies and public corporations are bought and sold on the floor of a stock exchange.
3. In a stock exchange, transactions take place between members or their authorised agents on behalf of the investors.
4. In a stock exchange all transactions are regulated by the rules and bye-laws of the concerned stock exchange.

Factors affecting prices in a stock exchange are:

1. Interest rate: If there is a change in the rate of interest charged by banks on loans and overdrafts, there is a change in the speculative activities, and security prices also change as a consequence of it. Thus, if banks allow credit at lower interest rate, it may induce people to borrow money from banks and engage more in speculative activities to make profits. Hence, price of securities may go up as a result of speculative buying. However, if the interest on bank credit goes up, borrowing will be reduced and demand for securities will be relatively lower. Hence prices of securities will tend to go down.
2. Activities of the financial institutions: When financial institutions start buying securities on a large scale, prices tend to move up because it leads to high expectation among the public about the prospects of the company and there is increased demand all around. Similarly, if there is large scale selling of securities by financial institutions, the price tends to go down.
3. Performance of the company: The prospects of a company as regards future profits and dividend payment are often reflected in the rising or falling prices of its shares. This is because the profit earning capacity and expected dividend rates influence the expectations of investors about the rate of return on investment and future rise in prices. If the prospects are good, there is increased demand for shares, and prices move up. On the contrary, if a company's performance in terms of profit earning and dividend payment allows an unsatisfactory trend, the price of its shares start declining due to reduced demand.
4. Business cycles: Business conditions are periodically found to be subject to prosperity and depression. Prices of securities continue to rise during prosperity as bull speculators are active and go on purchasing securities. However, when speculators are unable to meet their liabilities due to lack of adequate funds, they are forced to bargain for sale as a result of which prices rapidly decline and cause a state of depression in the market.
5. Changes in Board of Directors: Sometimes, security prices change as a result of changes in the Board of Directors of particular companies. The death or resignation of a well known director may cause doubt or apprehension about the future prospects of the company concerned. In that situation, generally, there would be an adverse effect on the price of shares of that company.
6. Sympathetic fluctuation: The prices of securities traded in more than one stock exchange often change due to changes in another exchange. If the prices of some securities fall in one stock exchange due to some particular reason, it leads to a decline in the prices of the same securities in other exchanges too. This happens due to immediate communication among speculators.
7. Political events: Changes in the composition of government, changes in international relations, conflicts and political upheavals and wars between nations are always found to cause changes in the securities prices. This is because conditions of business and industry are generally affected by political events.
8. Changes in government policy: The changes in government policy with regard to taxation, import-export, price controls, licensing, etc. also influence the prices of securities, For example, if government decides to exempt dividends from income tax, the share prices will go up. If, on the other hand, government decides to raise income tax rates on company profits, the prices may fall. In fact, these days the policy changes by the government have become a major cause for an upswing or a downswing in prices of shares.

9. Miscellaneous factors: Various factors which may not be directly related with stock exchanges also affect prices of securities due to the psychological reaction of speculators. For example, unexpected changes in weather conditions, inadequate or excessive rainfall (which affects agricultural output), may bring about changes in the prices of shares of companies manufacturing fertilisers, edible oils, cotton textiles, etc. Similarly, lockout for a prolonged period may cause prices of shares to decline or illness of a powerful head of government may cause fall in security prices.

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

Role of entrepreneur are:

i) 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 explores the prospects of starting Business Organisation a manufacturing enterprise.

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

iii) 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.

iv) 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.

v) 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.

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

vii) 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.

viii) 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.

ix) 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.

The role of an entrepreneur is that of an initiator and promoter. In a sense, the role of an entrepreneur is also that of an expert having knowledge of product, market conditions and of the practical aspects of running a business. He should not be simply an imaginative thinker but also have the ability to judge what kind of business will click. His role is indeed crucial for the eventual success of a business. When an enterprise has been launched and it turns out to be profitable, the entrepreneur may decide to leave it, give up his ownership rights, and hand it over to others to run it. The basic responsibilities of an entrepreneur include the ability to seize an opportunity, to innovate, explore the prospects of profitable business, and then to complete legal formalities, raise funds and finally manage the business. The basic responsibilities of the entrepreneur. He has to face many obstacles, many problems and difficulties in the course of promoting business. He has to take decisions which may have long-run implications. An entrepreneur has thus to undertake many things. But the most important of these are: (i) innovation, and (ii) risk bearing.

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.

6. Explain the significance of foreign trade for a country, and state the problems encountered in foreign trade by Indian entrepreneurs. (4+6)

Ans: Significance of foreign trade for a country:

- i) Specialisation and efficiency of production: Foreign trade leads to specialisation 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 off-shore oil resources. But, it requires exploitation through sophisticated machines, technology, etc. which we do not have. Machinery and technology can be imported from the developed countries like USSR, USA, Japan, etc. This leads to best possible use of natural resources.