June 2010

ECO-01 Business Organisation

Part A

1. Distinguish between any two of the following: (5+5)

(a) Business and Trade

Ans: The key difference between trade and business is that trade involves buying and selling of goods, whereas business involves all activities performed by a business entity including buying and selling, advertising, marketing etc. The objective of trade is to make goods available to those persons who need them and are willing to pay for them. Whereas Business is carried with the intention of earning profits. 'Thus, trade plays 'a major role in establishing contact between the producers and the consumers and eliminates the hindrance of person. Trade refers to buying and selling of goods between customers and sellers in return for money. Trading activities bring association between seller and buyers. Whereas, business brings association between owner and the client. Business is the entire enterprise of making, selling, and controlling the production of goods, while trade, a narrower activity, involves only the buying and selling of goods. Trade is a part of business, but business is not the same as trade.

(b) Right issue and public issue of shares

Ans: In right issue, the shares are offered to the existing share holders. Whereas, in public issue application for shares are invited from the general public. The price of right issue is made much less than the current market price. On the contrary, the price of public issue is generally lower than the expected market price. There is no chance of over subscription in right issue. Oppositely, in public issue the share may be undersubscribed or oversubscribed. In the case of right issue, the cost of issue is comparatively lower. Contrarily, in public issue the cost of issue is high.

(c) Advertisement and Publicity

Ans: 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. Whereas 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. There is a huge investment to be made in advertising a single product. On the other hand, Publicity does not require any kind of investment. The key people behind advertising are the company and its representatives. On the contrary, Publicity is done by a third party which is not related to any company. Advertising is under the control of the company. However, publicity is not under the control of the company. Advertising repeatedly occurs to grab the attention of the customers. Oppositely, Publicity is done only one-time act. Advertising is always customer focused, i.e., the more creative the advertisement, the more are the customers attracted to it. On the other hand, publicity is not done keeping customers in mind. Advertising always speaks the goodness about a product, to persuade the target audience to buy it. Oppositely, Publicity, is unbiased, and so it will speak the reality, no matter whether it is goodness or illness. 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. In contrast to this, the 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.

(d) Pledge and Hypothecation

Ans: Bailment of goods as security against the debt for the performance of the obligation or the payment thereon, is known as the pledge. Hypothecation is a mode of creating charge on goods or related documents without the surrender of possession of goods. Hypothecation is the pledging of goods, against the debt without delivering them to the lender. Pledge is defined in Section172 of Indian Contract Act, 1872.On the other hand, hypothecation is defined in Section 2 of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.The borrower who pledges the property is called the 'pledged' or 'pawner' and the person with whom the property is pledged is known as 'pledgee' or 'pawnee'. The borrower who hypothecates the goods is known as 'hypothecator' and the lender is termed as 'hypothecatee'. Property remains with the creditor in case of pledger, whereas property remains with the debtor in case of hypothecation. In the pledge, the possession of the asset is transferred, but in the case of hypothecation, possession lies with the debtor only. In the pledge, when the borrower default in payment, the lender can exercise his right to sell the asset to recover the debt amount. Conversely, in hypothecation, the lender does not have the possession of goods so he will have to seize property first and then sellout. A pledge is utilized when there exists an actual possession of security/assets as collateral by the banks/lender to avail the loans. Hypothecation is used whenever loans are granted against movable security as collateral without actual possession of the property.

2. Write short notes on any two of the following: 5+5

(a) Underwriting

Ans: Development banks and financial institutions underwrite the issue of shares and debentures of public limited companies. Besides, investment trusts, stockbrokers, 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 the 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'. The commission agreed upon is generally a percentage of the issue price of the shares or debentures underwritten.

To the promoters of a company the most important advantage of underwriting 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. Every underwriter, before entering into an agreement, carefully examines the scheme of financing the business ventures prepared by the company.

The only disadvantage of underwriting is that it adds to the cost of raising finance. Thus, the rate of return on investment proposed to be made with the funds raised must be sufficiently high so as to absorb the additional cost of floating shares and debentures. But the significance of underwriting arrangement is such that even well-established profitable companies cannot avoid it while issuing additional shares or debentures to the public.

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 stockbrokers (share brokers) engage in underwriting business. Some of the well-known underwriting agencies in India are given below.

1. Development banks IFCI, IDBI, ICICI, SFCs

2. Investment Institutions LIC, GIC, UTI and Investment Companies

3. Commercial Banks State Bank of India, Central Bank, Bank of India, Bank of Baroda, etc.

4 Others Stockbrokers and financiers like the Firm of Place, Siddens and Gough, etc.

(b) Partnership deed

Ans: A partnership is formed by an agreement. Such agreement may be either written or oral. To avoid misunderstanding and unnecessary litigations, it is always desirable to have a written agreement. When the written agreement is duly stamped and registered, it is known as 'Partnership Deed'. After registration, each partner is given a copy of the partnership deed. A partnership deed, generally contains the following particulars:

1. Name of the firm.

2. Nature of the business to be carried out.

3. Names of the partners.

4. The town and the place where business will be carried on.

5.The amount of capital to be contributed by each partner.

6. The profit and loss sharing ratio of each partner.

7. Loans and advances by partners and the interest payable on them.

8. The amount of drawings by each partner and the rate of interest allowed thereon.

9. The rate of interest on capital.

10. Duties, powers, and obligations of partners.

11. Remuneration , if any, payable to the active partner.

12. Maintenance of accounts and arrangements for audit.

13. Settlement in the case of dissolution of partnership.

14. The methods of evaluation of goodwill on admission or death or retirement of a partner.

(c) Direct channels of distribution

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

They establish direct link with the consumers through travelling salesmen or through their own retail shops or showrooms. The producer or manufacturer may employ salesmen to book orders by contacting the potential users, and supply may be arranged from the stock held by the producer himself. Alternatively, the producer may set up retail shops/show rooms in different localities and sell goods directly to the customers as shown below.

1. Producer --> Travelling Salesman -->Consumer
2. 2 Producer --> Retail shop/showroom --> Consumer

(d) Warehousing

Ans: 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.

Warehousing refers to the storage of goods on a large scale and as a specialised function. It involves providing facilities for preservation of goods in proper condition so as to prevent loss or damage and making the goods available to traders or dealers for sale. Warehouses are places where storage facilities exist. Thus, warehousing is an essential aid to trade or ancillary of trading activity.

There are three types of warehouses which provide facilities for proper storage of goods:

• Bonded warehouses: Bonded warehouses are those which are located in or near ports where imported goods are stored till importers fulfill all formalities and take delivery of them. When an importer is unable to take delivery of the goods by paying the required customs duty, the customs authorities permit the goods to be kept in a bonded warehouse, and allow delivery as and when the duty is paid. The bonded warehouses are licensed specially for storing imported cargo on which customs duty is yet to be paid. Goods stored in a bonded warehouse are said to be ‘in a bond’. These warehouses are usually owned by Government but can also be privately owned in which case they are subject to government supervision and control. Bonded warehouses enable importers to pay customs duty on the goods as and when it is convenient. The import duty is not required to be paid on the entire lot at the same time. Delivery of a part of the goods be taken on payment of the proportionate amount of duty. Besides, these warehouses also can provide services of branding, blending and packaging, thereby,

facilitate reexport of the same. Moreover, buyers are allowed to inspect the goods there. Thus, importers can recover the amount of duty included in the price when the goods are delivered directly to the buyers.

• Public warehouses: Public warehouses are those which provide warehousing facilities to manufacturers, producers, as well as traders on payment of specified charges. These warehouses are located at favourable sites on railway routes and highways and near ports. Public warehouses are privately owned by organisations, as well as by the central and state governments. Public warehouses run by dock authorities facilitate storing of goods which cannot be immediately shipped on reaching the port, or imported goods where importer is not able to take immediate possession. Mechanical handling of heavy goods is also possible at warehouses on railway routes and at ports. Small scale manufacturers and traders cannot afford to build warehouses of their own and can Transport and Warehousing make use of public warehouses located in different regions. The warehouses also provide the facilities of grading, blending and packaging. These warehouses also undertake loading and unloading of goods and arrange delivery according to the owner's direction.

• Private Warehouses are owned by large manufacturers and wholesalers for storing goods of their own. The maintenance of these warehouses is the responsibility of the owners. These warehouses are not available to the traders and producers in general and hence have limited usefulness.

Part B

Attempt any three of the following questions:

3. “Company form of business organisations emerged essentially because of the limitations and failures of the partnership form of business organisations.” Discuss. (10)

Ans: Partnerships have the disadvantages of limited resources, unlimited liability, limited managerial skills, etc. The life and stability of these organisations also depend on the life and stability of the proprietors/partners. Hence, they are not considered suitable for large scale business. Large-scale businesses requires large investment and specialised managerial skills. The element of risk is also very high. This situation is led to the emergence of company form of business organisation. In case of company form of organisation, capital is contributed by not one or two persons but by a number of persons called shareholders. Thus, it is possible to raise large amount of capital. A company form of business organisation is an association of persons registered under Companies Act for carrying on some business. It is called an artificial person as it is created by law, with a distinctive name, a common seal and perpetual succession of members. It can sue and be sued in its own name.

In partnership form of organisation, liability is unlimited. In respect of business debts, each partner has unlimited liability. This means that if the assets of the firms are not sufficient to meet the obligations of the firm, the partners have to pay from their private assets. The creditors can even realise the whole of their dues from one of the partners. Thus, all the partners are jointly and severally liable for all business debts and obligations. Whereas, in company form of organisation, liability is limited. 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.

Since there is a limit of' maximum partners (20 in non-banking firms and 10 in banking firms), the capital raising capacity of the partnership firms is limited as compared to a joint stock company. Since company form of organisations are allowed to have a large number of shareholders, it is possible to raise capital in large amounts. Whenever new capital is required, it can issue shares and debentures. For this reason, only the company form of organisation is best suited.

In partnership form of organisation, no partner can transfer his interest in a firm without the consent of other partners. In company form of organisation, the members enjoy a statutory right to sell his share to others without the consent of other shareholders.

As a company is an artificial person so that it can enter into contracts in its own name, the members are not held liable for the acts of the company. But in the case of a partnership form of business organisation, a partner can enter into a contract in their own name with the mutual consent of the other partners, and they can also be sued for the acts done by the firm.

In company form of organisation, the membership is very large, so the business risk is divided among the several members of the company. This is an advantage for small investors.

The sudden death, lunacy or insolvency of a partner leads to the dissolution of partnership. This breeds uncertainty in the continuity of a partnership firm. A joint stock company has a continuous existence. Its life is no1 affected by the death, lunacy, insolvency or retirement of its shareholders or directors. Members may come and go, but the company continues its operations until it is legally dissolved. Partnership form of organisation is managed by all the partners, there is no separate professional managers appointed due to lack of resources. Whereas, company form of organisation is managed by highly professionalised experts and Board of Directors.

Since they are more in number, most of the shareholders of the company may not know each other. We cannot expect that all the shareholders are just and honest to one another. But in the case of partnership, the partners know each other thoroughly. The partnership agreement is based on utmost good faith. So the partners are to be just and honest to one another.

Companies pay income tax at flat rates. There is no provision for slab system in the taxation of companies. As a result, companies pay lower taxes on higher incomes compared to other forms of organisations. Companies also get some tax concessions if they are established in backward areas.

Companies are subject to Government controls and regulations. Their accounts are audited by a chartered accountant and are to be published. This creates confidence in the public about the functioning of the company. Whereas in partnership form of organisation, Since the accounts are not published and publicised, the firm may not be able to command confidence of the public.

4. What do you understand by capital structure? If you promote a car manufacturing company, what factors do you keep in mind while deciding on the capital structure of the company? (2+8)

Ans: 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:

i. 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.

ii. 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.

iii. 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.

iv. 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.

v. 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.

vi. 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.

vii. 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.

viii. 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. "Different channels of distribution are used for different products." Explain with reasons.(10)

Ans: The distribution channels can be classified into two categories:

i) Direct channels ii) Indirect channels

Direct channels: When the producers sell their goods directly to the consumers it is called a direct channel. No middlemen is present between the producer and the consumer. They' establish direct link with the consumers through travelling salesmen or through their own retail shops or show-rooms. The producer or manufacturer may employ salesmen to book orders by contacting the, potential users, and supply may be arranged from the stock held by the producer himself. Alternatively, the producer may set up retail shops/show rooms in different localities and sell-goods directly to the customers as shown below:

i) Producer --> Travelling Salesman -->Consumer

ii) Producer --> Retail shop/showroom -->Consumer

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. As shown below, there could be four indirect channels.

i) Producer-->Retailer-->Consumer

ii) Producer-->Wholesaler-->Consumer

iii) Producer--> Wholesaler-->Retailer-->Consumer

iv) Producer-->Agent-->Wholesaler-->Retailer-->Consumer

We can classify the goods into two categories: 1) consumer goods, and 2) industrial goods.

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 channels of distribution for different products is not the same.

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.

Channels of Distribution Used for Industrial Goods:

The goods which are consumed by industry for further production of goods are called industrial goods. Under this category there are a variety of products such as machinery, equipment, industrial raw-materials (e.g. sugarcane, cotton, coffee, oilseeds, iron ore, etc.), electrical and electronic components, etc. The channels of distribution are not similar for all the products under this category.

High value industrial goods like mainframe computers, aircraft, heavy machinery, etc., are supplied directly to the buyers. In these cases manufacturers procure orders by mail on the basis of catalogues and price lists. Sometimes salesmen are also used to contact the buyers. Relatively less expensive items like trucks, conveyor systems, etc., are supplied through distributors. Industries consume many agricultural products. For instance, tea leaves are processed to prepare tea powder which we use for preparing tea. Agricultural products like corn, coffee, soyabeans, etc., are procured by the industrial buyers through' agent middlemen. When electrical components are imported from foreign markets, they are procured through an agent and industrial distributor.

6. "All business risks are not insurable." In the light of this statement, explain insurable risks and non-insurable risks.

Ans: Those risks which can be covered up by some type of insurance policy are called insurable risk. Insurable risks are risks in which the insurance provider can calculate potential future losses or claims. The loss causing factor should not be within the control of the insured in the case of insurable risk. Risks due to war (except cargo at sea) and certain risks such as radio activity arising from nuclear fusion are non-insurable risk. The characteristics of the insurable risks are as follows:

i. The risk should be accidental or random in nature. The loss causing factor should not be within the control of the insured. Thus, the loss which has occurred already or which is very likely to occur cannot be insured. For instance, a building which is on fire or which is already destroyed by fire cannot be insured against fire.
ii. The amount of loss should be measurable and possible to estimate. This condition is necessary to set the premium at appropriate levels.
iii. There should be a sufficiently large number of units exposed to the same risk. In other words, there must be a large number of people interested to insure against the same risk.
iv. The units facing the same risk must be spread over large geographical area. In other words, the risk must be spread over a wide geographical area so that the happening of a single event in a small region may not cause heavy burden to the insurer.

Whereas those risks which cannot be covered up by some type of insurance policy are called Non-insurable risk. Non-insurable risks are risks which insurance companies cannot insure because the potential losses or claims cannot be calculated. The risk should be accidental or random in nature. The risks which do not fulfill the above mentioned (characteristics of insurable risks) characteristics are non-insurable risks. Non-insurable risks include:

i. Risks due to war(except cargo at sea) and certain risks such as radio activity arising from nuclear fusion.

ii. Risks incapable of measurement such as unforeseen changes in fashion, marketing of new products etc.

iii. Risks too small and recuring too frequently, or risks so large and recurring so infrequently.

7) Why is it considered necessary for the government to directly participate in business and industry? (10)

Ans: The government controsl the private enterprises on one hand and directly participate in the business on the other. Government today is engaged in various types of business undertakings. There are several types of servlces which are provided by govern~nent organisations such as electricity, water, postal, telecommunications, transport services, ztc. Besides these organisations, there are many manufacturing industries owned and inanaged by govcmment. They produce steel, locomotives, machine tools, watches, railway coaches. telephone equipment, and so on. Government undertakings are also involved in the supply of consumer goods like milk (through government milk schemes), bread (Modem Bakeries), cloth (National Textile Corporation), etc.

The reasons for the direct participation of government in business and industry may be divided into three categories:

i) basic reasons

ii) ideological reasons

iii) specific reasons.

i) Basic reasons: The government of India was rightly convinced that political independence without economic independence would not have much meaning. It was, therefore, decided to industrialise the country in a big way as early as possible.

The government felt that if the private sector was to take the initiative. it would take an unduly long time to achieve this objective of rapid industrialisation. It was so because the private enterprises lacked adequate entrepreneurship and resources to start large scale ventures.

The government encouraged private enterprises to set up new industries, but also, went into industry in a big way.

It was decided to establish steel plants. fertilizer factories and other units necessary for industrial and agricultural growth. The following is a list of some major enterprises and power projects set up by the

government within a decade of Independence- Steel Plants at Rourkela, Bhilai and Durgapur, Indian Telephone Industries.

The intention of the government was to have economic self-reliance in as many areas and as early as possible.

ii) Ideological reasons: Apart from the economic and social consideration, the government had strong ideological commitment to the philosophy of public ownership of the means of production.

iii) Specific reasons: There are many other reasons for the government to participate in business. These are specific to a particular decision. Some of these are listed below.

* Air Transport Business: Till 1953, there were many private air companies in the country. Most of these were financially unsound and had no money to invest in modem and costly aeroplanes, The air transport is of strategic importance to the country. The government, therefore, nationalised nine air companies and created Indian Airlines Corporation and Air India International Corporation in 1953.

* Insurance Business: Today, the whole of insurance business is with the government. The life insurance business is operated through the Life Insurance Corporation of India and other types of insurance business through the General Insurance Corporation of India and its four subsidiary companies.

The government went into the life insurance business in 1956 nationalising scores of private companies which were not fulfilling the main objective of the life insurance business, namely, i) effective mobilisation of the people's savings, ii) spreading the message of insurance as far and as wide as possible, and iii) using the insurance funds for economic development.

* Commercial Banks: The government today is in the banking business in a big way. Over 90% of commercial banking is in the hands of the government. The government rightly wanted the banking system to serve the developmental needs of the economy in conformity with national policy and objectives. It also wanted the banks to have new criteria for advancing loans in order to benefit the weaker sections of the society.

* Coal Industry: The coking coal mines were nationalised in 1971. It was done because coking coal which is essential for production of iron and steel has very limited reserves in the country. The private sector was mining this fast depleting and scarce natural resources in a very wasteful manner. Other coal mines were also nationalised in 1973. The reasons for this were: i) the private sector owners did not have the necessary funds required for increasing the coal production, ii) the coal which is a scarce natural resource was being mined in a very unscientific way, and iii) the private coal miners were greatly exploiting the labour employed in the mines.

* Oil Industry: In the 1970's the foreign oil companies Burmah Shell, Caltex and Esso were nationalised. Here the objective was that lhe government should have control over a critical and strategically important resource like oil.

* Various Other Types of Business: There is yet another important reason for the government going into business of various types. Over one hundred cotton textile mills and dozens of engineering and other enterprises have been taken over by the government since Independence. This is done because the government cannot afford to lose production capacity which exists in the units which become sick and which the private sector wants to close down.

From the above, we can conclude the reasons for participation of Government as:

i) The government's role in business in India is greatly justified by economic and social reasons.

ii) Had the government not initiated a large number of industrial activities, the Indian economy would never have got the sound base and self-reliance which it has today.

iii) A large number of enterprises have been forced on the government when they became sick and they could not be allowed to be closed down due to social and economic reasons.

iv) There is an element of ideology in the role which the government has in business today. Had the ideology not been there, the government would have disengaged itself from at least some of its business activities after completing its role as path finder or initiator.

v) 5) The government continues .to be in business in a big way because of ideological as well as economic and social considerations.

8. (a) Why do the prices of securities traded on a stock exchange fluctuate widely ? (5)

Ans: Factors affecting prices in a stock exchange are:

i) 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.

ii) 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.

iii) 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.

iv) 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.

v) 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.

vi) 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 I 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.

vii) 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.

viii) 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.

ix)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.

(b) Foreign trade is an engine of economic growth in a country". Comment.(5)

Ans: Nations, like individuals, do not possess everything they need to fulfil their requirements. Even countries like the USA, USSR and China, which are rich in natural and human resources have to look to other countries for supply of some of their requirements. For instance, consumers in USA obtain their supply of sugar and coffee from other countries. Moreover, different countries possess different types of resources. Those which have a surplus of certain resources find it beneficial to sell the surplus items to some other countries and buy other items which they need. Such exchange of goods and services between people, across national boundaries is called 'foreign trade' or 'international trade*. Foreign trade can ' be bilateral or multilateral. When there is tr3de between people of any two nations, it is bilateral: foreign trade is multilateral when people of any country buy from and sell to people of more than one country.

Production of goods and services requires different resources like men, materials, money, machines and management. If we compare the resources possessed by nations it will be found that no country is self-sufficient and there are differences in the quality and quantity of domestic resources available in different countries.

Indeed, it is this difference in the relative abundance or shortage of resources in different countries that has given rise to foreign trade involving exchange of goods and services between countries. Through international trade, it is possible for a country to avail of goods which it cannot produce or cannot

produce as economically as other countries. Hence, a country's well-being is determined to a great extent by the nature and extent of its foreign trade. Let us discuss the importance of foreign trade to people in different countries.

Foreign trade is an engine of economic growth in the country because:

i) Specialisation and efficiency of production: Foreign trade leads to specialisation in productive activities undertaken by different countries. Depending on n 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) 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 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.
iii) 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.
iv) 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.
v) Employment opportunities: Foreign trade facilitates the growth of agricultural as well as industrial activities which in turn generates more employment in the country.
vi) 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.