June 2012

ECO-01 Business Organisation

PART-A

1. Distinguish between any two of the following : 5+5=10

(a) Sole trader and partnership.

Ans: Partnership organisation emerged essentially because of the limitations and failures of sole proprietorships. The sole trader organisations have limited financial resources, limited managerial ability and skills, and unlimited liability. In case of expansion more capital and more managerial skills are required. At the same time, the risk will also increase. A sole proprietor may not be able to fulfil all these requirements. A person who lacks, managerial skills may be having capital. Another person who is a good manager may not be having sufficient capital. This calls for a situation where two or more persons come together, pool their capital and skills, and organise the business. This type of business organisation is called partnership organisation. It grew essentially because of the limitations and failure of the sole proprietorships.

The sole trader organisation (also called proprietorship) is the oldest form of organisation and the most common form of organisation for small business even today. It is the simplest and easiest to form.

Limited resources: The sole trader has to depend on his own earnings or he can borrow from relatives and friends. This is because a sole trader has got limited capital and resources.

Limited managerial capacity: To carry on a modem business, knowledge and skills regarding production, finance etc., are required. His decisions may not be balanced and it is impossible for a single person to possess expertise in all the areas mentioned above.

Less stability: The business continues and remains stable till the sole trader remains alive. If he dies, there is a chance of closure of business.

No check and control: No checks and controls are there on the proprietor. As he is the only proprietor of the business, one cannot question him on his acts and deals.

Not suitable for large scale operations: Due to the limited resources, it is appropriate for small business and not for carrying out large scale operations.

Less scope for scale economies: As the sole trader operates on small scale, he cannot enjoy benefits of large scale buying or selling.

These limitations brought sole proprietorship to an end and it gave birth to partnership organizations. Partnership is an association of two or more persons who have joined together to share the profits of business carried on by all or any of them acting for all. Partners are the persons who own the partnership business. All the persons are collectively called the firm or partnership firm. Because of the merits of partnership organization, it came into existence.

More capital available: Unlike sole proprietorship, there are two or more partners in partnership firms. So, in partnership firm does not have to rely on a single individual as the source or its funds. The added financial strength of the partners increases the borrowing capacity of the firm.

Flexibility: Like sole proprietorship, the partnership business is also owned and run by the partners themselves. They can easily appreciate and quickly respond to the changing conditions.

Protection: The rights of all partners are fully protected. If a partner is not comfortable with the firm's working, he can ask for the firm's dissolution and withdraw himself from the business.

More diverse skills and expertise: A good partnership brings together those partners who complement one another and not those who have the same background and experience. One partner could be a specialist in finance, another in marketing and the third one could be in manufacturing. If all the partners give a combined judgment, the decisions would be better and balanced, and not hasty and reckless. More partners are there, that is why, partnership involves more people in decision making.

Keen interest: As the partners are liable to losses and risks of a business, they take proper and keen interest in the business affairs.

Checks and controls over careless decisions: In this form of organization, there are fewer chances for hasty and reckless decisions. This is due to the reason that a firm is run on collective basis and all the partners take part in major decisions.

Diffusion of risk: In this, one doesn't have to bear the whole amount of the loss. It is so because the losses of the firm are shared by all the partners.

Secrecy: In partnership firms, some secrecy can be maintained because there is no obligation to publish accounts of the firm.

Easy formation: Although the formation of a partnership firm is not as easy as the sole proprietorship, but it is much less difficult as compared to a company. The partners agree to do business together and draw up and sign the partnership agreement. After that there are no complex government laws regulating the establishment of the partnership.

If more people come together they can not only pool their capital and skills but organize the business properly. A sole proprietor may not have both capital and skills to fulfill the requirements.

(b) Capital market and money market

Ans:

Capital Market	Money Market
A marketer including all institutions, organisations, and instruments providing medium and long-term funds is known as a capital market.	A market for short-term funds that is meant to use for a period of upto one year is known as Money market.
The participants of capital market are banks, financial institutions, foreign investors, ordinary retail investors from public, and public and private companies.	The participants of money market are banks, financial institutions, foreign investors, and public and private companies. However, ordinary retail investors from public do not participate in this market.
The capital market deals in securities of medium and long term.	The money market deals in securities of short-term with a maximum tenure of one year.

The securities that comes under the capital market are considered liquid. It is because of the stock exchange. However, these securities are less liquid as compared to the instruments of money market.	Money market securities are highly liquid.
The instruments of a capital market are riskier. The investors may face the risk in return as well as principal repayment, as the companies issuing the securities may fail.	The instruments of a money market are less risky or safe as they are used for a short period of time and also because of the soundness of the issuers.
The expected return of a capital market is higher. It is because along with regular interest or dividend, the investors have chances of capital gain.	The duration of money market is short; therefore, the expected return here is less.
Companies approach capital market when they need fixed capital.	Companies approach money market when they need working capital.
Transactions involving procurement of funds and supply of funds which take place among individuals and various organisations may be regarded as the capital market.	Transactions involving borrowing and lending of money for short periods for which again there is not definite place set aside in a town
Shares, debentures,bonds,retained earnings etc.	Treasury bills, Commercial papers, Certificate of deposit, trade credit etc.

(c) Direct channels and indirect channels of distribution.

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

(d) Current account and savings bank account.

Ans: Current accounts are intended for businessmen, joint stock companies, public institutions, etc., whose banking transactions happen to be numerous on every working day. A current account is a running and active account which may be operated upon any number of times during a working day. There is no restriction on the number and the amount of deposits or withdrawals from this account. Since the amount from this account is repayable on demand, the banks are required to keep sufficient cash to meet such demands. Therefore, the banks pay no interest on current account deposits. The banks charge incidental charges on an unremunerative current account for the work and expenses involved in its maintenance.

The main advantage of current account is that the customers are relieved from the botheration of handling cash. Third party cheques with endorsements can be deposited in the current account for collection and credit to customer's account. Overdraft facilities are given in this type of account and loans and advances are granted by the bank.

Whenever any person or a group of persons or a firm wants to open a current account with a bank, they have to make a written request in the prescribed form. The forms contain the particulars about his name, his address, his trade or profession, his specimen signature and references etc. Before opening a current account in the name of a person, the bank should satisfy itself regarding the customer's character, integrity and respectability. For this purpose, the applicant must be introduced either by a respectable person known to the bank or known to the staff of the branch. If an account is opened without proper introduction, cases of fraud or misrepresentation may occur and the bank and the general public may suffer losses. After all the above formalities are over, the bank should receive the initial or first deposit from the customer. When an account is opened, the bank supplies to the customer a 'Pay-in slips 1book', a cheque book and a pass book. Now in place of the pass book, the banks send to their customers every month a statement of account showing therein the transactions that have taken place during the month.

A customer can deposit money or cheques in his account by filling up the requisite pay-in slip. Whenever he wants to withdraw money or wants to make payment to some one, it is done by issuing a cheque. The customer should check up the entries in the pass book or statement of account with the counterfoils in his possession.

A savings bank account is opened and operated by people who wish to save a part of their income for his future needs and also earn some interest on his deposits. This type of account is intended to promote the habit of saving among depositors, therefore, some restrictions have been imposed on the number and the amount of withdrawals from this account. The banks allow interest on the minimum balance standing to the credit of an account during the period from the 10th day of the month to the last day of every month.

The procedure of opening a savings bank account is similar to the procedure of opening a current account. For opening a savings bank account, the customer has to fill up the prescribed form, giving details about his name, address, occupation, etc. Before opening the account, the bank should seek proper introduction to satisfy himself about the integrity and respectability of the applicant. The bank should obtain specimen signature of the applicant. This account can be opened by depositing a minimum balance prescribed by the bank. The bank then opens an account in his ledger and provides the customer with a pay-in slip book, a cheque book (if customer wants) and a Pass Book.

A customer operates this account through these documents - a pay-in slip (for depositing money in the account), a cheque or withdrawal form (for withdrawing or payment to others) and a pass book. When a cheque book is issued to a customer, he is required to maintain a minimum balance in his account. Interest is payable on the minimum balance according to the rates prescribed by Reserve Bank of India from time to time.

2. Write short notes on any two of the following : 5+5=10

(a) Containerisation

Ans: Containerisation refers to the technique of using specially made containers for transportation of goods. It involves carriage of goods in large box like containers that can be loaded and unloaded to and from trains, trucks, ships and air crafts by mechanical devices instead of manual labour being engaged in transferring packaged lots. Containerisation is intended to eliminate manual handling of cargo, mechanising the operation and ensuring automatic control over transfer of goods in containers from storage to carriers and from one type of carrier to another. Containers can be hauled by trucks to railway yards, docks or airports and can be transferred readily to rakes, flatcars, ships or airplanes, thus, the main advantage of containerisation is its adaptability to efficient transfer between different modes of transportation. The transfer can be made by mechanical devices with minimum use of manual labour. For sea transport, operation of larger and faster general cargo vessels has become possible due to containerisation. Specialised container ships are required for the purpose, and it involves heavy capital expenditure. Even then it is found economical since loading big containers is easier, less time consuming and less costly compared with loading of small boxes or pieces. Movement of cargo by air may also be possible more conveniently with the prospect of containerisation enabling goods to be loaded and unloaded using highly automatic mechanical devices. However, it remains to be seen whether it is economically feasible to operate huge air freighters which are required to cany containerised cargo. In the West European countries and the United States, containerisation has become an integral part of the transport system. It is gradually gaining ground in India. At present Inland Container Depots (ICDs) serve as dry ports to promote exports and imports from and to inland locations.

(b) Public utility undertaking

Ans: Water, gas, electricity, transport communication, etc.,, are needed by the public in their daily life. Whenever there is any interruption in the supply of such goods or services, the normal life of people is disturbed. For example, If the electricity supply or transport services are not available, public life and activities are severely upset. these services have a great significance to the community. Hence they are termed as essential services or indispensable necessities. The business enterprises established basically to provide efficient and uninterrupted supply of the goods that are absolutely indispensable for a civilised community are referred to as public utility organisations. public utilities are the business undertakings engaged in supplying essential goods and/or services of daily necessity for the general public. The institutions which undertake certain essential services like the Supply of gas, water, electricity, urban transport, etc., are examples of 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.

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 Tor 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.

Characteristics of public utility undertaking are:

1) Indispensability: Public utilities deal with essential services such as water, gas, light, power, transport, telephone, telegraph, postal services, etc. These services are required to meet basic needs of the community and to provide a civilised and comfortable life to every citizen irrespective of caste and creed. Therefore, these services must be made available regularly, uniformly and adequately. That is why these public utilities are indispensable in all modem societies.

2) Field of operation: The field of operation of public utility undertakings is mostly local. Such concerns fulfil the needs of the citizens, usually of a city, town or at the most of a district. Fo; example, Delhi Milk Supply Undertaking or Mother Dairy supplies milk through its booths at various localities to the people living in Delhi only.

3) Monopolistic or semi-monopolistic position: Undertakings supplying essential public services by nature assume the position of a monopoly. They do not have competitors. You can take the example of Delhi Electric Supply Company. It does not have any competitors for supplying electricity to the residents of Delhi. If another undertaking is involved in the same operation in the same town, equal amount of money is required which is a waste. To avoid any such wasteful expenditure, monopoly is given to public utilities. However, some public utilities may have a few competitors. Take the case of milk supply in Delhi. Mother Dairy supplies the milk. But Delhi Milk Supply Undertaking or Nanak Milk Supply Company also supplies milk in Delhi. Therefore the position enjoyed by Mother Dairy is semimonopolistic.

4) Regulation and control : These undertakings enjoy a monopolistic or semi-monopolistic position. So, they are in a position to misuse it and exploit the customers. For instance they may supply poor quality goods, services may be irregular, may charge high prices, etc. The government has to ensure the quality of the products or services at reasonable prices. Public is to be assured of regular and adequate supply of services and goods without discrimination. Therefore, it is essential to regulate their working as well as the price and supply policies of public utilities. Regulatory powers of the government in respect of these undertakings are provided in Special Acts of the legislature.

5) Franchise: Public utilities operate under franchise i.e. the right to interfere with public property (land, buildings, roads, etc.) for proper functioning. For example, the railways which is a public utility

undertaking, can put up barriers on roads restricting movement of traffic across railway track at level crossings. Similarly, water supply undertakings can dig pits across the roads whiIe laying water pipes, and so on. The government grants special rights as well as casts duties and responsibilities on these concerns through a charter which is called franchise. The franchise or charter contains the powers, privileges and rights granted to these undertakings as well as duties and liabilities for which these undertakings are accountable. This is done to ensure their working efficiently and satisfactorily. The franchise can be withdrawn if the undertaking does not comply with the regulations and resttictions subject to which the franchise is issued.

6) Huge capital investment: These undertakings require huge capital investment in fixed assets. Take the case of Mother Dairy which supplies milk in Delhi. For supply of milk . to its consumers it has to set up a milk plant, storage plant, and large fleet of vans1 tankers. It has also to construct depots for distribution of milk at various places in different localities of Delhi. Then, it has to monitor the distribution of milk to its consumers properly. Thus, all the public utilities invest huge amount of capital in fixed assets.

7) Risk involved: The degree of risk involved in the business carried out by the public utilities is less as compared with other industries. This is because the demand for essential goods and services is not likely to fall, rather it is likely to increase over time. For instance, the demand for water, gas, milk, electricity, etc., is not likely to fall but increase since the population is increasing continuously year after year.

8) Non-transferable demand by the consumer: The demand of the consumer is nontransferable. If a consumer is provided electricity at his house, he cannot transfer his right of using electricity to his neighbour. Every consumer is to obtain the supply separately after fulfilling the rules and regulations of the undertakings.

9) Choice of site: The promoters of public utilities do not have much choice in the selection of site for the undertaking. They have to locate their enterprise as per the permission granted to them by the concerned authorities. They have to operate as per . the prescribed local conditions and regulations.

10) Size of the undertaking: These undertakings are required to be set up on a sufficiently large scale so as to meet the demand of the public of that locality. Moreover, the size of the unit must be large enough to make it possible for the undertakings to supply the service continuously at economical rates.

(c) Fire insurance

Fire policies cover the losses directly caused through fire. However, it is necessary that fire must happen by ignition. If the fire is caused through the malicious act of the insured himself, he would not be able to recover the loss from the insurer. The fire insurance contract is an indemnity contract.In addition to fire, the standard fire policy covers such perils as lightning, explosion of domestic boilers, gas used for lighting and heating, and damage by water used to extinguish a fire on neighboring property. For a small additional premium the policy may be extended to cover such other items as storm and flood, earthquakes and impact from road vehicles or aircraft, but not glass and china, jewellery,manuscripts and other items of value, except where specially mentioned.Fire policy is for a fixed period. During that period if there are successive fire accidents, the insurer is liable to make good of all those successive losses.

Types of Fire Policies:

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

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

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

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

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

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

(d) Chain stores

Multiple shops or Chain stores are retail stores located at different places under the same ownership and management, and deal in similar products. It is a system of large-scale retailing through stores located as near as possible to the residential areas. Since the stores are owned and managed by the same organisation, they are also known as chain stores. These stores may be established by manufacturers or trading companies. The more important features of the multiple shop system are as follows:

i) A limited range of products are sold through the shops.

ii) The same tvpe of products are sold by every shop.

iii) Goods are centrally purchased or produced and supplied to each store which is run by a manager.

iv) There is uniformity in the setting and outward appearance of the stores and interior display of goods.
v) Prices are fixed by the central office and the same price is charged in every - store.

In India, chain stores have been established by a number of manufacturing companies like Delhi Cloth Mills, National Textile Corporation, Mafatlal, Bata Shoes, Jay Engineering Works (Usha Brand products).

PART-B

Attempt any three of the following questions :

3. What is a joint stock company ? Explain as to how it overcomes the limitations of partnership form of organisation. (2+8)

Ans: The Indian Companies Act (1956) defines joint stock company as "a company limited by shares having a permanent paid up or nominal share capital of fixed amount divided into shares, also of fixed amount, held and transferable as stock and formed on the principles of having in its members only the holders of those shares or stocks and no other persons."

In case of joint stock company, 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 joint stock company 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.

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. "Stock exchange is a barometer of the economic and business conditions in a country." Discuss. 10

Ans: A stock exchange is a reliable barometer to measure the economic condition of a country. Every major change in the country and economy is reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. The stock exchange is also known as a pulse of the economy or economic mirror which reflects the economic conditions of a country.

The intensity of buying and selling of securities and the corresponding rise or fall in the prices of securities reflect the investors' assessment of the economic and\business conditions. Thus, during periods of economic and business prosperity prices of securities tend to rise. Conversely, prices tend to fall when there is economic stagnation or when business activities slow down as a result of depression in the markets. Indeed, change in security prices are known to be highly sensitive to changing economic, social and political conditions.

5. Why are the channels of distribution different for different products ? 10

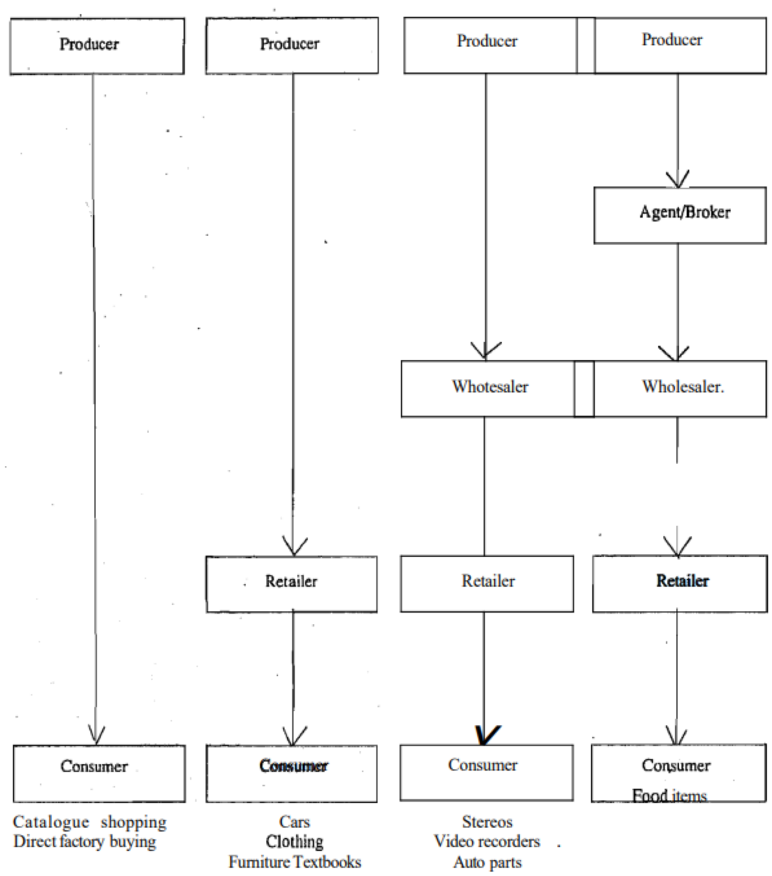
Ans: We can classify the goods into two categories: 1) consumer goods, and 2) industrial goods.

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 channel of distribution used for different product is not the same. Channels are different from one type of product to the other. It gives the idea about the channels of distribution for some of the consumer goods.

As shown in the figure, 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 s\ells 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.

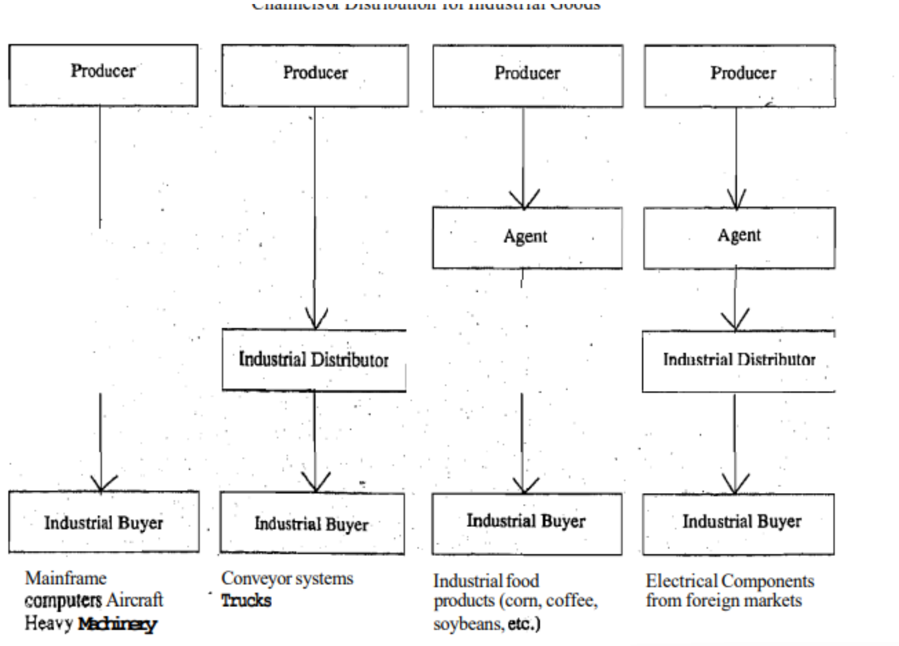
Figure 10.1
Channets of Distribution for Consumer Goods



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 7 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.

Figure below presents the channels of distribution for some of the industrial goods.



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 syskems, etc., are supplied through 4 distributors. You know industries consume many agricultural products. For instance, tea leaves are processed to prepare tea powder which we hse 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. "Banks provide various types of advances to its customers according to their needs and repayment capacity." Explain. 10

Ans: Advances form the main source of income for a bank. Bank advances enable' trade, commerce, industry and agriculture to meet their financial requirements.

Primary concern of a bank as a lender should be 'safety' and 'liquidity' of advances. Besides, banks also need a good return from the employment of their funds to meet their expenses. This is known as 'profitability'. Banks have to maintain a balance between liquidity and profitability in such a way that they should be able to meet the demand of depositors for cash and at the same time earn sufficient profit from the advances.

Naturally the banks should not lock up the funds in few investments for a long period of time This is risky from the point of view of safety of investments.

Banks provide various types of advances to its customers according to their needs and repaying capacity. The advances may be in any of the following four forms: (1) loans, (2) overdrafts, (3) cash credits, and (4) discounting of bills.

1) Loans

A loan is a financial arrangement under which an advance is granted by the bank to the borrower on a separate account called the loan account. When a loan is granted against security or otherwise, the entire amount of loan is paid to the borrower in lump sum either in cash or by transferring the amount to his account in the bank. Whenever borrower repays some money, the loan account is credited by that amount and the loan account is debited with the amount of interest and incidental charges. Interest is charged on the whole amount of loan sanctioned, irrespective of the amount actually withdrawn by the borrower. However, the rate of interest on loan is slightly lower than that charged on an overdraft and a cash credit.

Loans are sanctioned for short, medium and long periods. Loans repayable within a period of one year are called short term loans. They are suitable to meet the working capital needs of the business firms. Loans repayable within a period ranging from one to five years are termed as medium term loans and such loans are granted to finance expansion and development plans. Commercial banks normally grant short term and medium term loans only. When a loan is given for more than five years, it is called a long term loan.

The loans to individuals are granted on the basis of personal security and guarantee by another person. Loans to trade, industry or agriculture are granted against tangible and intangible securities.

The banks prefer to grant loans because of the following three reasons: (1) the bank can collect interest on the entire amount of loan sanctioned, (2) it involves very little accounting work, (3) the bank can review the loan account periodically. The main drawback of the loan system is that every time a loan is needed, it is to be negotiated afresh. Further, the banks have no control over the use of funds borrowed by the customer.

The big advantage of taking a loan is that money will always be available over the agreed period and cannot be recalled as a result of restrictions imposed on bank lending. However, the main disadvantage to the borrower is that he is required to pay interest on the entire amount of loan, whether he has actually withdrawn the amount or not.

2) Overdraft

An overdraft is a financial arrangement under which a current account holder is permitted by I the bank to withdraw more than the credit balance in his account, upto an agreed limit. Thus, by nature, it is a temporary financial accommodation to be made use the customer occasionally. The overdraft facility is given to those who have a current account with the bank and whose business relations with the bank continue to be good. Besides that, bank also considers the business of the customer, his reputation, how far the arrangement will help the customer to improve his business, aqd ability to repay the money to the bank.

An overdraft is granted either against collateral securities or against the personal security of the borrower. An overdraft arrangement is very advantageous to the borrower as interest is charged on the amount actually overdrawn by him. But it is not advantageous to the bank because, while he can charge interest on the amount actually overdraft, he is required to keep at the disposal of the customer the full amount of overdraft sanctioned. In order to protect the interest of the banker agreement a minimum interest clause is included in the agreement, which requires the customer to pay a minimum rate of interest on the sanctioned amount of overdraft, if the overdraft is not utilised fully.

3)Cash credit

Cash credit is the main method of lending by banks in India. Cash Credit is a financial arrangement between the bank and the customer under which a bank allows his customer to borrow money upto a certain limit against the security of tangible assets or guarantees. The amount is credited to a separate account and the customer is allowed to operate the account.

In the case of cash credit, the borrower need not withdraw the whole amount at once. He can withdraw the amount in instalments as and when needed. Further, he can deposit into the 1 account any surplus amount which he has in his hands. Thus, you note that it is an active I t running account to which deposits and withdrawals may be effected frequently. However, the debit balance in a cash credit account on any day should not exceed the cash credit limit. A cash credit is usually a more permanent financial arrangement than an overdraft.'

Interest is charged not on the amount of cash credit sanctioned to him, but on the amount actually utilised by him for the actual period of utilisation.

Though the cash credit arrangement is very popular with borrowers, it is disadvantageous to the bank. While bank can charge interest only on the actual amount utilised by the borrower, but he has to keep at the disposal of the borrower the entire amount of cash credit sanctioned. For this reason, there is a provision of charging commitment charge on the unutilised portion of the cash credit limit. Normally, the minimuin interest clause is included in the cash credit arrangement. However, it is very difficult for the bank to verify the end-use of the loan.

4)Discounting of Bills

Discountillg ofbills of exchange is another important form of lending. Under this system the bank takes a bill of exchange maturing within a short time, say 60 days or 90 days and credits the customer's account with the amount of the bill after some discount. The bank waits upto the date of maturity of the bill and presents it on the date of maturity to the drawee for payment. Since the bank has to wait till the date of maturity, the banks charge interest for the remaining duration of the bill and this amount is known as 'discount'.

Banks normally accept only such bills which are considered eligible for discount under the directions of Reserve Bank of India. The bills mostly discounted are documentary bills i.e., a bill of exchange accompanied by documents of title to goods. In case the bill is dishonoured on the due date, the bank recovers the amount of the bill together with interest and other charges from the customer. llie bank has to take care that the dishonoured bills are immediately sent to the customer to enable him to take the necessary legal action.

The main advantage of discounting of bills is that, though the bank has no tangible assets with it as security, the bank can recover the full amount of the bill from the customer by debiting , I his account. It is a method of short-term financing. The bank is certain that after the stated period, the amount will be realised, so the bank can utilise its funds mme profitably.

7. In the present day context, do you think it is necessary for the government to directly participate in business ? State your views. 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 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. 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 the 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) The government continues to be in business in a big way because of ideological as well as economic and social considerations.

8. Explain the procedure, one has to follow when goods are imported. 10

Ans: Import trade procedure differs from country to country depending upon the satisfactory requirements and trade practices in force. The general procedure of import trade in India involves the following stages:

i. Trade Enquiry

ii. Obtains import License

iii. Obtains Foreign Exchange

iv. Places the Order/Indent

v. Arranges Letter of Credit

vi. Gets Shipping Documents

vii. Clears the Goods

viii. Makes Payments

Trade enquiry: The intending importer makes trade enquiry from the possible exporters. His enquiry is based on the details of the goods required by him viz., quality, design, size, etc. and seeks information regarding the availability of goads, the price at which they would be available and the tens and conditions regarding delivery and payment. In response to his enquiry, the importer may receive a number of quotations which will contain particulars as of the goods available in ready stock, their quality, size, design, etc. The different quotations will also specify the price at which the goods should be available and the terms and conditions of sale. Once quotations from different suppliers have been received, a thorough comparison should be made of the various quotations before taking the decision to import.

Obtains import License : In order to obtain an import licence, the intending importer makes an application in the prescribed form, to the Licencing Authority. When the licensing authority is satisfied with the claims, he issues the licence. The import licence is issued in duplicate. 'The first copy is presented by the importer to the customs authority at the time of clearance of goods and the second copy is used for obtaining foreign exchange from Reserve Bank of India. Although raw materials, intermediates, capital goods and other items announced by the central government may be imported freely under Open General Licence (OGL) scheme.

Obtains Foreign Exchange: After obtaining the import licence, the importer makes arrangements for obtaining the necessary amount of foreign currency. In India, the Reserve Bank of India (RBI) is authorised by the Government to regulate the use of exchange. Every importer has to produce import licence along with the prescribed application form under the Exchange Control Act. The exchange bank of the importer endorses and forwards the application to the Exchange Control Department of RBI. The RBI sanctions the release of the amount of foreign exchange to the importer after scrutinising the application on the basis of the existing Government policy.

Places the Order/indent: After obtaining the import licence and requisite amount of foreign exchange, the next step is to place the order or indent for import of the goods. An indent is a form of order sent abroad for goods to be imported. The indent contains Full details regarding the goods to be imported and the terms and conditions regarding price, shipment, delivery, the method of payment, etc. An indent may be 'open', 'closed' or 'confirmatory'. When the selection of goods and other details are left to the agent's discretion in the foreign country, it is called an 'open indent'. A closed indent contains full particulars of the exact goods required. When an order is placed subject to the confirmation by the importer's agent, it is called confirmatory indent. Every importer is free to place the order directly or through the intermediaries, specialised in such trade. These specialised agencies are called indent houses. An indent house refers to an import agent or import firm, which imports goods on orders received from importers. The indent house serves as middlemen between the importers and exporters. They charge certain percentage of commission for their services from the importer. If the importer wants to make use of services of an indent house, he has to enter into an agreement with the indent house for the supply of specified goods.

Arranges Letter of Credit : Depending upon the terms of the importer may have to arrange a letter of credit to be issued by his bank in favour of the exporter. All the terms and conditions agreed upon between the importer and exporter are generally spelt out in the letter of credit. The importer's bank issues the letter of credit authorising the correspondent bank in the exporter's country to buy the bill drawn by the exporter on the importer, or to accept the bill drawn on the bank itself. The importer's bank may require adequate amount to be deposited by the importer so as to cover the amount for which the letter of credit is issued.

A bank may issue any of the following types of letter of credit.

i) Revocable letter of credit: It can be withdrawn or altered or revoked at the discretion of the issuing bank without the prior consent of the exporter.

ii) Unconfirmed irrevocable letters of credit: It cannot be cancelled or altered or withdrawn by the issuing bank prior to the date of expiry, without the consent of the exporter and is thus much safer.

iii) Confirmed irrevocable letters of credit : The irrevocable letter of credit shall be more safe if it is confirmed or guaranteed by a bank. With a confirmed irrevocable credit, the bank must pay the exporter, whatever happens to the importer or the foreign bank.

Gets Shipping Documents: After receiving order and the letter of credit, the exporter ships the goods and intimates the importer that the goods have been despatched. The exporter draws a bill of exchange on the importer's bank for the full value of goods payable to him. The bill of exchange, accompanied by all the shipping documents viz. commercial invoice, bill of lading, insurance policy, and the certificate of origin (if needed), are forwarded to the importer's bank by the exporter's bank. Under the letter of credit arrangement, the importer's bank will handover the documents to the importer who would take steps for getting the goods cleared from the customs authorities. In the absence of a letter of credit, the bank will follow the instructions of the exporter in the matter of delivering the documents to the importer. If the bill of exchange is marked D/A (documents against acceptance), the documents will be delivered to the importer on the acceptance of the bill. If the bill is marked DIP (documents against payment), the documents will be delivered to the importer only on payment of the amount of the bill.

After taking possession of the documents of title to the goods, the importer waits for the arrival of the ship. When the ship arrives at the port of destination, the importer arranges clearance of the goods from the customs office in whose custody the goods lie after being unloaded from the ship. This requires a number of formalities to be completed. The importer may appoint a clearing agent for that purpose. Clearance of goods requires the following steps to be taken: (i) get the bill of lading endorsed by the shipping company for delivery of the goods or a delivery order issued by the shipping company (ii) pay the necessary amount of port trust dues representing the cost of services rendered by the dock authorities in connection with the loading of goods (iii) fill up a 'bill of entry' containing all particulars relating to the imported goods and the customs duty to be paid. After import duty has been paid, the importer has to submit the 'bill of lading ' 'port trust dues receipt' and 'bill of entry' to the shipping company for release of the goods. In case the importer is not in a position to pay the customs duty in full immediately, he may apply to the customs authorities to get them placed in the bonded warehouse. The importer can pay duty for part of the goods as and when he wants to get delivery.

Makes payments: The mode of payment for import depends upon the agreement between the importer and the exporter. If the documents have been received against acceptance (D/A bills), the importer has to honour the bill of exchange on the due date. After the bill is paid, the importer transaction comes to a close. In case of documents against payment (D/P bills), the importer pays immediately or within a short period after presentation, because the importer gets possession of the documents of title to the goods only on payment of the bill.