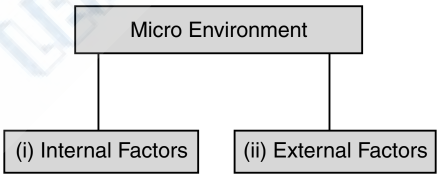
Chapter - 1 : Business Environment

REVISION NOTES

Business Environment and its Dimensions

- **Meaning:** Business environment can be defined as "the forces factors, and institutions with which the businessman has to deal with to achieve its objectives."
- **Features:** The main features of business environment are:
  1. **All the external forces:** Business environment includes all the forces, institutions and factors which directly or indirectly affect the business organisation.
  2. **Specific and General forces:** Business environment includes specific forces such as investors, customers, competitors and suppliers which affect the business directly and general forces like social, economic, legal and political that affect the business enterprises indirectly.
  3. **Inter-relation:** All the forces and factors of business environment are inter-related to each other.
  4. **Dynamic:** Business environment is highly dynamic. It is not static or rigid. It keeps on changing due to frequent changes in government policy, demand, new technology, etc.
  5. **Relativity:** The impact of business environment may differ from company to company or country to country.
  6. **Uncertainty:** It is very difficult to predict the changes of business environment as environment is changing very fastly.
- **Importance of business environment: The understanding and awareness of business environment is must due to following points:**
  1. It enables the firm to identify opportunities and getting first mover advantage.
  2. It helps the firm to identify the threat and early warning signals.
  3. It helps to adjust and adapt with rapid changes.
  4. It helps in increasing company's image.
  5. It helps in formulation of places and policies.
  6. It increases the efficiency and performance of the enterprise.
- **Dimensions of Business Environment: There are two main dimensions of business environment:**

  1. Micro Environment **2. Macro Environment**



  1. **Micro Environment:** Micro Environment refers to those internal and external factors which exercise a direct influence on the working and performance of an individual business organisation. It has two broad categories as follows:
     - **(i) Internal factors:** It refers to all those factors which exist within a business firm. These factors are controllable because the firm has control over these factors. The main internal factors which influence business organisations are as follows:

       (a) Top management structure **(b)** Corporate culture

       (c) Mission and objectives **(d)** Human and other resources
     - **(ii) External factors:** The external factors refer to those individuals and groups or agencies with which business organisation is constantly interacting.

       Micro Environment consists of the following external elements:

       (a) Customers: Including individuals households, government departments, etc.

       (b) Competitors: A company may have both direct and indirect competitors.

(c) **Suppliers:** Suppliers refers to the people and group who supply raw materials.

(d) **Middlemen:** Middlemen like agents, wholesalers, and retailers serve as a link between the company and its customers.

(e) **Financers:** The shareholders, financial institutions, debenture holders and banks provide finance to the company. Financial capacity policies and attitude of financers are important factors for the company.

2. **Macro Environment:** Macro Environment is the general environment or remote environment which may affect all business enterprises. Macro Environment is also known as indirect action environment. Forces in the macro environment are uncontrollable and non-measurable. Success of an enterprise depends on its ability to adapt to the macro environment. Macro environment consists of the following components:

(i) **Economic Environment:** If refers to the nature of economy (capitalist, socialist or mixed) economic policies of the government. It includes gross domestic product, income level at national income, per capita level, monetary and fiscal policies of the government, etc.

(ii) **Social Environment:** Social Environment consist of the customs and traditions of the society in which business is existing. It includes the standard of living, taste, preferences and education level of the people living in the society where business exists, the business man can not overlook the components of social environment as these components play very important role in the business.

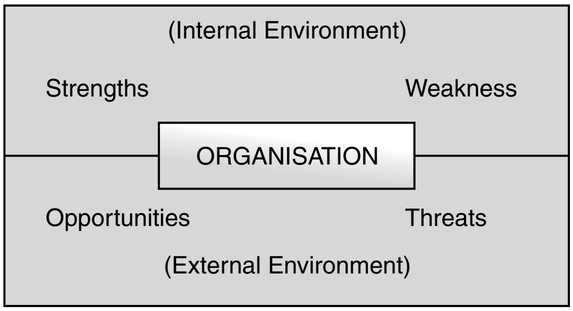
(iii) **Political Environment:** Political Environment constitutes all the factors related to government affairs such as type of government in power, attitude of government towards different groups of societies, policy changes implemented by different government, etc. The political environment has immediate and great impact on the business transactions so businessman must scan the environment very carefully.

(iv) **Legal Environment:** Legal environment constitutes the laws and various legislations passed in the parliament which has affected the business transactions. Trade Mark Act, Essential Commodity Act, Weights and Measures Act, etc are common rules.

(v) **Technological Environment:** Technological environment refers to the state of technology in the area of manufacturing, mining, construction, transportation, etc. The businessman must closely monitor the technological changes taking place in the competitive markets. Technological changes always bring quality improvement and more benefits for customers.

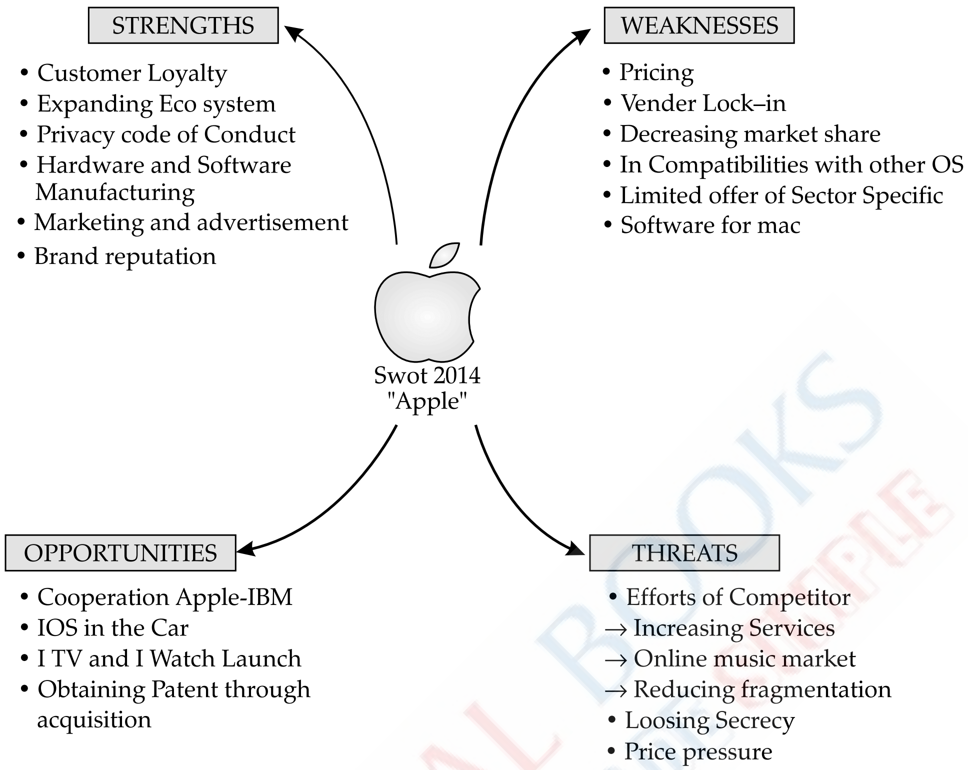
SWOT Analysis

- **SWOT** is acronym strengths, weakness, opportunities and threats. It is formed for analysing and formulating an effective strategy that can capitalise on the opportunities and neutralise the threats faced by an organization. SWOT analysis is a systematic and logical approach to understand the environment of a business organisation.
- **Strength (S):** Strength is an inherent capability of the company which it can use to gain strategic advantages over its competitors.
- **Weakness (W):** Weakness is an inherent limitation of the company which creates strategic disadvantages for it. The firm may face problems due to poor management and ineffective policies, etc.
- **Opportunity (O):** An opportunity is a favourable condition in the company's external environment enables it to strengthen its position. Economic liberalisation and globalization offer opportunities to companies which that want to enter banking, insurance and telecommunication sectors.
- **Threat (T):** Threat is an unfavourable condition in the company's external environment which causes damage or risk to its position. Competitions from multinational corporations is a threat for Indian firms.



SWOT- Model of Environment Analysis

Example:



KNOW THE TERMS

- **Business Environment:** It is the forces, factors and institutions with which the businessman has to deal with to achieve its objective. It is the surroundings in which business exist.
- **Micro Environment:** Those internal and external factors directly influence the working and performance of an individual business.
- **Macro Environment:** General environment which may affect all business enterprises. It is uncontrollable and non-measurable.

❑❑

Chapter- 2 : Financing

REVISION NOTES

Concept of Business Finance, Importance and Sources of Finance, Financial Planning–Objective & Importance

- **Business Finance:** Business finance refers to the money employed in the business. It is the arrangement of cash and credit in the business firm at all times.

  Business finance may be defined as planning, raising, managing and controlling all the money and capital funds of any kind used in connection with business.
- **Importance of Finance for Business:** Finance is the lifeblood of business. No business firm can carry on its operations smoothly and successfully without the finance. **Importance of finance for business as follows:**

  (1) In business, finance is required for

  (i) Establishing an enterprise

  (ii) Purchase of fixed assets and current assets

  (iii) Expansion, growth and modernisation of business

  (2) The firm can meet its liabilities in time.

(3) The firm can take advantages of business opportunities.

(4) The firm can carry on its business smoothly and without any interruptions.

(5) The firm can face recession, trade cycles and other crises more easily and confidently.

➢ **Source of finance for different types of business firms:** Capital requirements differ according to the nature and size of business. Requirement of capital for different types of business firm are as follows:

(1) Source of finance for sole proprietor ship firm

(i) Owned capital and retained earnings.

(ii) Loans from friends and relatives.

(iii) Loans from banks and financial institutions.

(iv) Long term loans from state financial corporations.

(v) Short term finance from commercial banks.

(2) Source of finance for partnership

(i) Owned capital contributed by partners in agreed ratio.

(ii) Retained profits.

(iii) Loan from commercial banks and financial institutions.

(iv) Short term loans from suppliers of raw materials and finished goods.

(3) Source of finance for joint stock company

(i) Issue of shares.

(ii) Retained profits.

(iii) Issue of debentures and bonds.

(iv) Long term loans from financial institutions.

(v) Short term loans from commercial banks.

➢ **Financial Planning:** Financial Planning is the process of determining the objectives, polices and procedures, programmes and budgets to deal with the financial activities of an enterprise. Financial planning involves both short term and long term planning. The steps in financial planning are as follows:

(1) Determination of financial objectives.

(2) Estimation of capital requirements.

(3) Determination of kinds of securities to be issued.

(4) Formulation of financial policies, procedures and budgets.

Types of Capital: Fixed and Working Capital

➢ **Meaning of Fixed Capital:** Fixed capital refers to the funds required for acquisition of fixed assets that are to be used repeatedly over a long period of time. Fixed assets are those assets which are required for permanent use by the company and are not meant for resale.

➢ **Factors affecting Fixed Capital:** The various factors that affect the fixed capital are as follows:

(1) Nature of the business: Nature of the business varies fixed capital requirement. Manufacturing companies require heavy investment in fixed capital such as land, building and plant and machinery while trading enterprises require less fixed capital.

(2) Size of the business: A large scale enterprise generally requires more fixed capital than a small scale enterprise. For example: Public utility concern like railways and electric supply companies require huge investment in fixed assets.

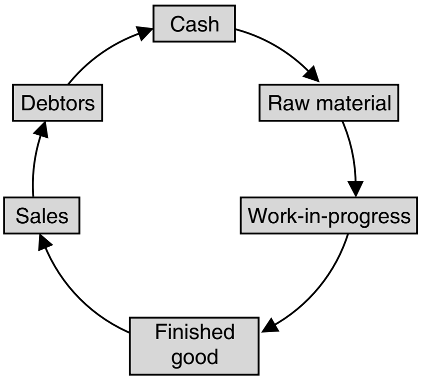
(3) Types of technique: Service and assembling industries require a huge amount of fixed capital than what is required in other processing and synthetically processing industries.

(4) Growth Prospects: Where a company wants to take growth opportunities, it might decide to expand into new products and new markets. It would require greater amount of fixed capital.

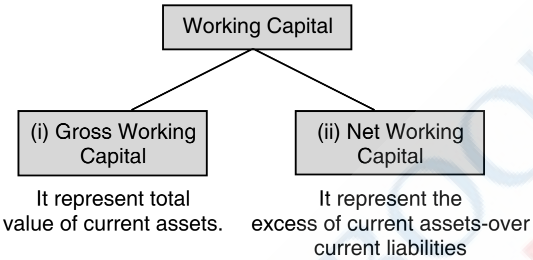
(5) Diversification: A firm may choose to diversify its operations in various areas. If a firm diversify its operations then the fixed capital amount will be increased.

(6) Level of Collaboration: If the companies are preferring collaborations, joint ventures then companies will need less fixed capital as they can share plant and machinery with their collaborators but if company prefers to operate independently then there is more requirement of fixed capital.

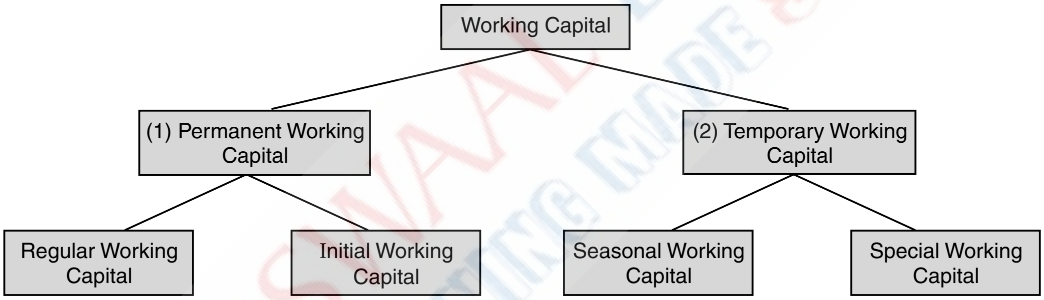
➢ **Working Capital:** Working Capital is that portion of capital which is required for holding current assets like stock of materials and finished goods, bills receivable and cash for meeting current expenses like salaries, wages, rent etc. Working capital is also know as "Circulating capital or revolving capital" because it keeps on circulating or revolving in business.



The term working capital is used in two sense: gross working capital and net working capital.



Types of working capital: Working capital can be divided into two broad categories:



(1) Permanent working capital: It refers to the minimum amount of working capital which is required to operate the minimum level of business activity. It is permanently locked up in current assets. It can be of two types:

  (i) Regular working capital: is that part of working capital which is required for continuous business operations. It represents the excess of current assets over current liabilities.

  (ii) Initial working capital: That part of working capital which is required at the time of starting of a business. It is that amount which is needed to start the business.

(2) Temporary working capital: It is that working capital which is required in addition to the permanent working capital. It is required to meet seasonal and special needs of the business. It can be of two types:

  (i) Seasonal working Capital: It means additional working capital which is required during a particular season.

  (ii) Special working capital: It is that part of working capital which is required to meet future contingencies in the business.

- **Factors affecting working capital:** The amount of working capital required by an enterprise depends upon the following factors:

(1) Nature of business: The business unit which do not keep very high stock of finished goods and which sell goods on cash basis need less working capital while trading concerns need huge amount of working capital.

(2) Scale of operations: The size of the concern has a direct relation with the working capital requirements. Big enterprises need higher working capital for investment in current assets. Whereas small enterprises need lesser working capital for investment in current assets.

(3) Business cycle fluctuation: During boom period the market is flourishing, so more demand, more production, more stock. Hence, more working capital is required. Whereas during recession, market is facing a downfall, so less demand, less production, less stock and less working capital is required.

(4) Technique of production: If a company is using labour intensive then company will have to maintain more working capital. If a company is using capital intensive then company will have to maintain lesser working capital.

(5) Growth prospects: Firms planning to expand their activities will require more amount of working capital as for expansion they need to increase scale of production.

(6) Inflation: If there is increase or rise in price then the price of raw materials and cost of labour will rise. It will result in an increase in working capital requirement.

➢ **Comparison between Fixed and Working capital:**

Basis	Fixed Capital	Working capital
Definition	Fixed capital is invested in fixed assets like building, plant and machinery, furniture, etc.	Working capital is invested in current assets like raw materials, debtors and bills receivable, etc.
Nature	It remains fixed in the business	Fluctuates from time to time
Term	Fixed capital is invested for long time period.	Working capital is invested for short time period
Purpose	Fixed capital helps in generating income.	Working capital is kept to meet day to day expenses.
Source	Fixed capital is raised from long term and medium term source of finance. Its main sources are shares, debentures, loans, etc.	Working capital is raised from short term sources of finance. Its main sources are commercial bank, trade exalt public deposits, etc.

Equity Shares, Preference Share, Bonus Shares, Right issue, ESOP, Sweat Equity Shares, Retained Earnings

➢ **Meaning:** A joint stock company requires two types of finance:

(1) long term finance (2) short term finance. Long term finance can be raised by issue of shares, debenture, retained earnings, long term loans, etc.

➢ Sources of Long Term Finance:

(1) Equity shares

(2) Preference shares

(3) Retained earnings

(4) Debentures

(5) Loans from commercial banks

(6) Loans from financial Institutions.

➢ **Equity shares:** Equity shares are those shares which are owner of the company and bear all the risks of the business. It is the Owner's Capital therefore it is also known as owner's equity.

➢ **Features of equity shares:** The features of equity shares are:

(1) Owner's Capital: Equity share holders are the actual owners of the Joint Stock Company and they bear the primary risk. Equity shares are issued before other source of finance.

(2) Voting right: Equity share holders are the actual owners of the company so they have voting rights.

(3) Participation in management: They have full right to participate in the management of the company.

(4) Permanent Capital: Equity Capital is permanent in nature because it is repaid in the last in the event of winding up of the company.

➢ **Advantages of equity shares:** Equity shares have advantages from the company's point of view and from the shareholder's point of view. These are as follows:

➢ **Advantages of equity shares from company's point of view:**

(1) Permanent Capital: Equity capital is permanent in nature as it is refunded only at the time of winding up of the company. There is no liability as to repayment on it. At the time of winding up equity shares are paid in last.

(2) No charge on assets: Equity shares do not create any charge on the assets of the company. The company is free to use its property for raising loans.

(3) **No burden on earning:** Equity shares impose no burden on the company's resources because the dividend on such share is payable only at the discretion of the management.

(4) **Unlimited Source:** Through the equity shares a company raises huge amount of finance.

➢ **From investors/shareholders point of view:**

(1) **Voting right:** Equity shareholders enjoy voting rights and controlling power over the company.

(2) **Pre-emptive right:** Equity share holders have right to get first new issue of share by the company such share are called Right shares.

(3) **Limited Liability:** The liability of the equity share holders is limited to the face value of shares subscribed by them.

➢ **Disadvantages of equity shares:**

➢ **From company's point of view:**

(1) **Danger of over capitalisation:** Capital raised from equity shares is not refundable during the life time of the company, so there is a possibility of over capitalisation resulting in lower rate of earning and dividend.

(2) **No trading on equity:** When the whole finance is raised through equity shares, the benefit of trading on equity is not possible.

➢ **From shareholder's point of view:**

(1) **High risk:** Equity shareholders have high risk as they have to go with the market conditions and prices of these shares keep on fluctuating.

(2) **Unhealthy speculation:** There is unhealthy speculation in the prices of equity shares. Directors and officers of the company may also involve in the speculation on the basis internal management knowledge.

➢ **Preference Shares:**

Meaning: Preference shares are those which carry the following two rights:

(1) They have a right to receive dividend at a fixed rate before any dividend is paid on the equity shares.

(2) When the company is wound up they have a right to the return of capital before that of equity shares.

➢ **Types of Preference Shares:**

There are following different kinds of preference shares:

(1) **Cumulative preference shares:** These share are those preference shares the holders of which are entitled to recover the arrears of preference dividend before any dividend is paid on equity shares.

(2) **Non-cumulative preference shares:** The holders of such shares get a fixed amount of dividend out of profits of each year. If no dividend is declared in any year such shareholders get nothing.

(3) **Participating preference shares:** These are those shares which have special right to participate in the surplus profits, if any, after dividend has been paid to equity shareholders.

(4) **Non-participating preference shares:** Such shares get only a fixed rate of dividend every year and do not carry a right to participate in the surplus profits.

(5) **Redeemable preference shares:** These shares are those which will be repaid by the company within a certain period in accordance with the terms of issue.

(6) **Irredeemable preference shares:** These share are those the capital of which cannot be refunded before winding up the company.

(7) **Convertible preference shares:** The share holders of these shares have a right to get their preference shares converted into equity share at their option according to the term of issue.

(8) **Non-convertible preference shares:** When the preference share holders do not have right to convert their preference shares into equity are called non-convertible preference shares.

➢ **Features of preference shares:**

(1) **Rate of dividend:** Preference shares are paid dividend at a fixed rate.

(2) **Payment of capital:** They have a right to receive payment of capital before any payment is made to equity shareholder.

(3) **Arrears of dividend:** If any year dividend is not paid on these shares than the arrears of dividend may accumulate.

➢ **Advantages of preferences shares:**

Preference share capital have the following advantages:

(1) **Flexibility:** Preference shares are flexible as amount on these share is repaid, when the company does not need it.

(2) **No charge on assets:** Preference shares are not charged on assets. The company keep its fixed assets to be used for raising loan in future.

(3) **No burden on finance:** Preference shares do not put any burden on financial position as dividend is paid only out the profits.

(4) **Safety of funds:** Amount preference shareholder always remain safe and their capital gets high returns.

(5) **Trading on equity:** Management can give more benefit to equity share holders when they are using preference share capital with equity because rate of dividend is kept low for preference shares.

➢ **Disadvantages of preference shares:**

Following are the disadvantages of preference shares:

(1) **Costly source:** The cost of raising finance through preference shares is greater than that of debentures so they are a costly source of finance.

(2) **Legal formalities:** When company issues preference shares, they have to follow several legal formalities which creates problems in raising finance.

(3) **Low appeal:** Preference shares have little appeal to investors. Most of the investors want security.

(4) **Lack of voting right:** Preference share holders do not carry any voting right in the company.

(5) **No capital appreciation:** Preference shareholders get only fixed rate of dividend and their capital does not appreciate. They are paid fixed amount at the end of certain (fixed) period.

Distinction between equity share and preference shares:

Basis	Equity Shares	Preference Shares
1. Nominal value	Generally low	Generally high
2. Degree of risk	Very high risk because dividend is not fixed.	Comparatively low risk because of fixed rate of dividend
3. Right to dividend	After dividend is paid on preference shares	Prior to dividend on equity shares
4. Refund of capital	Repayment after all other obligations are refunded	Prior to refund of equity capital.
5. Voting rights	Voting rights can be exercised	No voting rights
6. Appeal	To the bold adventurous investors	To the cautious and conservative investors
7. Redemption	Not redeemed during the life of the company	Redeemable preference shares are redeemed during the life of company.

➢ **Bonus Shares/Bonus issue:** When a company have large amount of undistributed profits they issue fully paid up shares to their existing shareholders, free of charge, This is known as Bonus shares.

Issue of Bonus shares is also known as bonus issue or capitalisation of profits of the company.

A Company must follow certain conditions before issue of bonus shares. These are as follows:

(1) There should be adequate undistributed profits.

(2) SEBI guidelines must be followed in case of bonus issue.

(3) Board of directors of the company must pass a resolution for making the bonus issue.

(4) Articles of Association of the company must permit the issue of bonus shares.

➢ **Rights Share or Right issue:** When a public company limited by shares wants to increase its subscribed capital by issue of new shares but before issue, the company will first give issue offer to existing equity shareholders, this type of issue is called right issue. These shares are offered to existing members at a price lower than the market price. However, it completely depends upon the choice of the shareholder whether he wants to buy these additional shares or not. This right is called pre-emptive right.

➢ **Employee stock option Plans (ESOP):** An employee stock option plan is a scheme under which an employee of the company is given a right to purchase a specified number of its shares at a particular price (usually below the market price) during a given period of time under Section 62 (1) (b) of The Companies Act, 2013. A company may offer shares to its employees under a scheme of Employees stock option by passing a special resolution in the annual general meeting of the company.

Merits: The merits of stock option scheme are as follows:

(1) This scheme would inspire the employees to have a high participation in the company.

(2) ESOP is a means to attract, retain and motivate the good and efficient employees of the company.
(3) This scheme boosts morale of employees.
(4) The scheme links compensation package closely to performance.

- **Sweat Equity Shares:** A company may issue sweat equity shares as per section 54 of Companies ACT, 2013. Sweat equity shares means equity shares issued by the company to its employees or directors at a discount or for consideration other than cash for providing know how or making available intellectuals property rights. Such shares can not be resold by their holders within period of 3 years shares. This is, called lock in period.

  Following conditions are prescribed for issue of sweat equity shares:

  (1) There must be of a class of shares already issued.
  (2) One year must have lapsed since company commenced business.
  (3) The issue must be authorised by a special resolution.
  (4) The share must be issued as per the SEBI Regulations.

- **Retained earnings/ploughing back of profits:** Retained earnings or ploughing back of profits refers to the process of retaining a part of the net profit every year and reinvesting it in the business.

  Merits:

  (1) It is the economical source of finance.
  (2) Shareholders get regular dividend on this.
  (3) The financial position of the firm remains fully flexible.
  (4) It can be used to stabilize the rate of dividend on equity shares.

  Demerits:

  (1) Heavy reinvestment of earning year after year may cause dissatisfaction among shareholders.
  (2) It may lead to unbalanced industrial growth.

Loans Capital–Debentures

- **Meaning of Debentures:** According to Section 2 (30) of the Companies Act, 2013 the " debenture includes stock, bonds and any other instrument of a company, weather constituting a charge on the asset of the company or not."

- **Characteristics or Features of Debentures:**

  (1) A Debenture is issued under the seal of the company.
  (2) It contains a contract for the repayment of principal sum on a specified date.
  (3) A debenture is issued by a company is the form of a certificate, which is a written acknowledgement of debt taken by the company.
  (4) A debentureholder receives interest on his debentures at a fixed rate, as mentioned in the certificate.

- **Types or Kinds of Debentures:**

  (1) **Secured or Mortgage Debentures:** These debentures are those which are secured by having a charge either on particular asset of the company in general. It is called a floating charge. Fixed charge denies the company from dealing with mortgaged assets, whereas the floating charge does not restrict the company from using the assets.
  (2) **Unsecured or Naked Debentures:** These debentures are those which are not given any security. The holder of such debentures are treated as unsecured creditors at the time of liquidation of the company.
  (3) **Registered Debentures:** Registered debentures are those which are payable only to those holders whose name and addresses are recorded in a register of the company called 'Register of Debenture holder'.
  (4) **Bearer Debentures:** Bearer Debentures are those which are payable to the bearer or holder of the debenture. These are transferable by mere delivery and the company does not keep any record of name and addresses of debenture holder.
  (5) **Redeemable Debentures:** Redeemable debentures are those debentures which will be repaid by the company at the end of a specified period or by instalments during the life time of the company.
  (6) **Irredeemable or Perpetual Debentures:** These are those debentures which are not repayable by the company during its life time. These debentures are payable only at the time of liquidation of company.
  (7) **Convertible Debentures:** Holders of these debentures are given an option to convert them into equity shares or other securities at a stated rate of exchange after a certain period.
  (8) **Non-convertible debentures:** These instrument retain the debt character and cannot be converted into equity shares.

➢ **Advantages of Debentures:**

Advantages of Debentures are as follow:

Advantages

(A) From the view point of company

(i) A company can raise funds through debentures at a low cost

(ii) Interest on debentures is paid at a fixed rate by the company.

(iii) Debentures are flexible as when company does not require them the debentures are redeemed.

(B) From the view point of debenture holders.

(i) Debentures are paid interest at a fixed rate irrespective of profits.

(ii) Debentures are secured by a charge on the company's assets.

(iii) this point sound like an advantage to the company rather than debenture holders.

another point could be:
Debenture holders get a high priority while repaying at the time of winding up of the company.

Disadvantages

(A) From the view point of company

(i) Interest on debenture is a burden on the company.

(ii) Debentures are charged on assets.

(B) From the view point of Debenture holders.

(i) Debenture holders do not have voting rights.

(ii) Debenture unit price remains higher than shares.

➢ **Distinction between Shares and Debentures:**

Basis of Difference	Shares	Debentures
Capital v/s Loan	A share is a part of capital of the company, therefore share holders are the owners of the company.	A debenture is a part of loan and debenture holders are the creditors of the company.
Dividend v/s interest	A shareholder gets dividend from the company.	A Debenture holder gets interest from the company.
Profit	Dividend is paid only when there are profits.	If the rate of interest is fixed than it must be paid irrespective or profit/loss.
Unsecure or secure	A share is always unsecured hence they bear more risk.	Debentures are secured on the assets of the company hence, they bear no risk.
Voting rights	Shareholders have voting rights in the company.	A debenture holders do not have any voting right in the company.
Payment	Payment of share capital is made after the repayment of debentures.	Payment of debenture is made before the repayment of share capital.

Loans From Financial Institutions and Commercial Banks

➢ Loans From Financial Institutions:

Meaning: Indian Government has set up several special institutions in the country to provide long term and medium term finance to business organisation. These institutions have become a major source of finance for the modernisation and expansion of the existing concerns. These institutions are not simply financial institutions. They also provide promotional, technical and managerial services. IFCI (Industrial Finance Corporation of India), IDBI (Industrial Development Bank of India), ICICI, (Industrial Credit and Investment Corporation of India), SIDBI (Small Industries Development Bank of India) are well-known development banks in the country. In addition, the LIC, General Insurance Corporation, SFCs (State Financial Corporations), NIDC, NSIC, UTI, etc., also help in providing finance to industries. These financial institutions have become the biggest source of finance for business in India.

➢ **Short Term Loans From Commercial Banks:** Commercial banks usually provide short term finance because most of their deposits are short term deposits. However, in some cases commercial banks also provide term loans for medium and long periods especially to Small Scale Medium Enterprises (SSMEs).

Meaning: Under a term loan, a bank advance a fixed amount in lump sum to the borrower for a specified period. The Interest is charged at a fixed rate on the sanctioned amount. The loan is advanced against the security of some assets or on the personal guarantee of the borrower.

➢ **Advantages:** The main advantages of institutions finance are as follows:

(1) Special financial institutions provide under writing facilities to new companies.

(2) The rate of interest and repayment procedures are convenient and economical.

(3) A company can obtain expert advice and guidance for the success and planning.

➢ **Disadvantages:** The main disadvantages of financial institutions are as follows:

(1) A number of formalities and documents are involved in the finance process.

(2) Many deserving concerns may fail to get assistance for want of security and other conditions laid by these institutions.

(3) Sometimes these institutions place restrictions on the autonomy of management.

➢ **Loan and Advances:** A loan is a direct advance made in lump sum which is credited to a separate loan account in the name of the borrower. The borrower withdraws the full amount in cash immediately and undertakes to repay it in one or more instalments.

➢ **Cash credits:** It is a revolving credit agreement under which a borrower is allowed to borrow upto a certain limit. Unlike a loan, it is a running account from which the amounts can be withdrawn and paid back from time to time, subject to the stipulated amount.

The bank can refuse credit when the creditworthiness of the borrower is unsatisfactory or when there is shortage of funds. The maximum amount known as the 'limit' is determined accordance to the financial position of the borrower.

➢ **Bank overdrafts:** It is a kind of a temporary financial accommodation extended by a bank to its regular customers. Under this arrangement, a customer having a current account with the bank is allowed to withdraw a specified amount. A business enterprise can enter into this arrangement to take care of a temporary (a few days) shortage of working capital. Interest in charged on the amount actually overdrawn and not on the amount sanctioned by the bank.

➢ **Trade Credit:** Trade credit is the credit extended by one business firm to another as incidental to sale or purchase of goods and services. In other words, Trade Credit is the credit extended by sellers to buyers at all levels of production and distribution process down to the retailer.

➢ **Advantages of trade credit:**

(1) Trade Credit is a very simple or convenient method of raising short term finance.

(2) No formalities are involved and the credit is readily available to reputed business firms.

(3) No interest is payable.

(4) No charge is created on company's assets.

(5) More economical.

➢ **Instalment Credit:** Instalment credit refers to the facility of buying machinery, equipment and other durable goods on credit. The buyer has to pay a part of the price of the assets at the time of delivery and the balance is payable in a number of instalments. The supplier charges interest on the balance due and the interest in included in the amount of instalment itself. Some suppliers provide instalment credit through finance companies and commercial banks. A business firm may also buy fixed assets on hire purchase basis. Under this arrangement, the ownership of the asset remains with the supplier until all the instalments are paid by the buyer.

➢ **Factoring (Accounts Receivable financing):** The finance companies or factors provide finance to business organisations through the purchase of accounts receivables. The debtors of the firm make payments to the finance company. The business organisation is relieved of the cost effort of collecting debts and bad debts.

OR

It refers to an arrangement whereby the book debt [trade debtors]/ sale or mortgage of book debt, are assigned to a Bank and payment is received against the debts balance in advance from the bank. This facility is provided by the bank on the payment of specified charges.

➢ **Customer Advances:** In certain cases, manufacturers or suppliers of goods require the customers to deposit an advance payment at the time of booking before the delivery of goods. The customers advance represents a part of the price of the goods ordered by the customers to be supplied at a later date. This arrangement is used in case of products which are in short supply or which involve a waiting period for delivery, *e.g.*, automobiles, telephone connection, etc.

- **Meaning of RTGS:** Real Time Gross Settlement (RTGS) is a system of transferring of funds from one bank to another bank on real-time and gross basis. Real Time' means there is no waiting period in payment-transaction. The transaction is settled as soon as it is processed. Gross settlement means the transaction is made on one to one basis without bunching or netting with any other transaction.

  RTGS system is controlled by the central bank of the country. In RTGS system, every bank along with the central bank is linked electronically Every bank maintains its account with the central bank.

- **Features of RTGS are as follows:**
  1. RTGS facility is available only to CBS enabled bank branches which are connected electronically.
  2. RTGS facility is available within specified time. Presently, it is available between 9.00 a.m. and 4.30 p.m. on weekdays and 9.00 a.m. and 2.00 p.m. on Saturday, excluding bank holidays.
  3. RTGS is primarily meant for transferring funds involving a large amount. Presently, minimum amount which may be transferred through RTGS is ₹ 2 lakh. There is no limit on maximum amount.
  4. Inter-bank transactions are settled on real time and gross basis. Thus, funds receiving bank credits account of the beneficiary within two hours after receiving advice from the central bank.
  5. Banks levy service charge on transfer of funds through RTGS. Presently, per transfer charge is as follows: ₹ 30 for transfer of ₹ 2 to ₹ 5 lakh and not more than ₹ 55 for transfer of more than this amount. However, receiving customer is not required to pay any charge. Outward transactions – ₹ 2,00,000 to 5,00,000 : not exceeding ₹ 24.50; (exclusive of tax, if any). Above ₹ 5,00,000 : not exceeding ₹ 49.50. (exclusive of tax, if any)

- **National Electronic Funds Transfer:** National Electronic Funds Transfer (NEFT) is a system that facilitates individuals and organisations having bank accounts to transfer funds from their accounts electronically to individuals or organisations having bank accounts. Transfer of funds from one bank branch to another or from one bank to another is settled in batches.

- **Features of NEFT are as follows:**
  1. NEFT facility is available to NEFT-enabled bank branches. An NEFT-enabled bank is one which is electronically connected and has been authorised by the Reserve Bank of India.
  2. Inter-bank transactions involving transfer of funds are settled in batches for which time duration is specified. Any transfer taking place after this time is settled in the next settlement cycle.
  3. There is no lower or upper limit on transfer of funds through NEFT.
  4. In case one does not have a bank account, the maximum amount than can be transferred through NEFT system is ₹ 49999.
  5. There is no minimum or maximum amount that can be transferred through NEFT when one has a bank account.
  6. NEFT transactions take place in batches.
  7. NEFT cannot be used to receive foreign remittances.
  8. **The sender of funds has to pay the following charges for NEFT:** NEFT Charges are waived off if the transactions are done through Internet banking or mobile app banking. The charges may be applicable only if it is done through the branch.

Transaction Amount	NEFT Charges
Amounts upto ₹ 10,000	**₹ 2.50 + Applicable GST**
Amounts above ₹ 10,000 and upto ₹ 1 lakh	**₹ 5 + Applicable GST**
Amounts above ₹ 1 lakh and upto ₹ 2 lakh	**₹ 15 + Applicable GST**
Amounts above ₹ 2 lakh and upto ₹ 5 lakh	**₹ 25 + Applicable GST**
Amounts above ₹ 5 lakh and upto ₹ 10 lakh	**₹ 25 + Applicable GST**

  9. The receiver of funds has to pay no charges.

- **Difference between RTGS and NEFT**

Basis	RTGS	NEFT
1. Processing	**Transactions are settled on real-time basis and individually.**	**Transactions are settled after a specified time and in batches.**
2. Amount Limit	**Minimum ₹ 2 lacs, no upper limit on transfer of funds.**	**No upper or lower limit on transfer of funds.**

3. Number of Transfer	**No limit on number of transfer per day.**	**Limit of 6 transfers each weekday and 3 transfer on Saturday.**

➢ **Demand Draft:** A demand draft is a negotiable instrument similar to a bills of exchange. A bank issues a demand draft to a client (drawer), directing another bank (drawee) or one of its own branches to pay a certain sum to the specific party (payee).

The following are the essential features of a Demand Draft:

(i) It is drawn by one office of a bank upon another office of the same bank.

(ii) It is payable on demand; and

(iii) Its payment has to be made to the person whose name is mentioned their in or according to his order.

➢ **Electronic Banking (E-Banking):** Electronic banking means banking transactions carried out with the help of computer system. Any user having a PC and a browser can access the bank website and avail the banking services.

➢ **E-banking gives the following advantages:**

(i) Customers get 24 hours and 365 days-a-year services.

(ii) Customers can make the permitted transactions from residence or office and even while travelling

(iii) Customers feel a sense of security. They do not face the risk of carrying cash.

(iv) Unlimited access to the bank increases customer satisfaction.

➢ **E-banking offers the following benefits to banks:**

(i) The bank gains a competitive advantage.

(ii) Centralised data base reduces load on branches.

➢ **E-banking have the following disadvantages:**

(i) It adds to cost as it requires computer or mobile device all the time that too with internet facility.

(ii) Illiterate people or the ones living in rural areas with no internet access derive no advantage of this facility.

➢ **The main forms of electronic banking are as follows:**

1. **Electronic Funds Transfer System (EFTS):** Under this system, money can be transferred from one account to another account. For example, a bank transfers wages and salaries directly from the company's account to the accounts of employees of the company.

   The main examples of EFT are as follows:

   (a) Direct credits: Salary, pension, dividend on shares, interest on debentures, commission, royalty, etc are directly credited to the bank account of a person.

   (b) Direct Debits: Loan instalment, school fees, insurance premium, telephone bills, electricity bills, water bills, club membership fee, credit card dues, etc. are directly debited to the bank account of the account holder.

   Electronic funds transfer offer the following advantages:

   (i) Payments are made on due dates.

   (ii) There is no loss in transit.

   (iii) There is no mishandling of cash.

   (iv) Transactions are effortless.

2. **Automatic Teller Machine (ATM):** ATM is an automatic machine. A customer can withdraw or deposit money with the help of this machine by inserting his ATM card and typing his personal identity number (PIN). It provides 24 hours money without a human cashier, clerk or bank teller.

3. **Debit Card:** A person can get a debit card once he opens an account with the bank. However, to use a debit card, the account holder needs to deposit money into his bank account. (Now-a-days, there are zero balance bank account and hence the account holder get a welcome-kit that includes a debit card. Hence money deposit may not be necessary to get a debit card.)

   Features of Debit card are as follows:

   (a) Issued by bank account holder at the time of opening a savings or current account.

   (b) Meant to facilitate withdrawal of money through ATM.

   (c) Used to check account balance, transfer money etc.

   (d) Used for shopping and making online payments.

   (e) Can be used to the extent customer has balance in his/ her bank account.

4. **Credit Card:** Anybody having good reputation can obtain a credit card from a bank. A person need not have money in his bank to get a credit card. The card holder can buy goods and services with the help of credit card. He keeps on depositing the money used as per the agreement with the bank. A credit card holder gets a bill on a bill date and is supposed to pay on or before the due date mentioned.

   Features of Credit card are as follows:

   (a) Issued by finance company or a bank.

   (b) Issued at the discretion of issuer after satisfying himself of the credit worthiness of applicant.

   (c) Allows holder of credit card to buy merchandise without actually paying for it at the time of sale.

   (d) User has to pay monthly bill which include the transacted amount along with fee for use the card.

5. **Tele Banking:** Under this system, the personal computer of a customer is linked by telephone to the bank's computer. The customer can get information about the balance in his account and latest transactions on the telephone. This facility is available round the clock.

6. **Core Banking Solution (CBS):** Under this system a customer becomes 'customer of the bank' rather than 'customer of a branch'. By opening a bank account in one branch the customer can operate the same account in all the CBS branches of the same bank anywhere across the country. It offers the following facilities:

   (a) Cash withdrawal facility from any of the CBS branches.

   (b) Updating of pass book at all CBS branches.

   (c) The facility of centralised corporate limits in all the CBS branches.

7. **SMS Alert:** Under this service, customer gives his/her mobile number. The bank records the mobile number in its computer system in the customer's account. Whenever, a transaction takes place in the customer's account the customer receives information about withdrawal and deposits by an SMS on his/her mobile phone. The SMS states the nature and amount of transaction, date of the transaction and the balance in the account on that date.

   Advantages of Mobile Banking:

   (i) Available 24*7.

   (ii) It is secure.

   (iii) It is convenient.

   (iv) Cost saving technology.

   (v) Novel way of selling banking and service products by bank.

➢ **Difference between Debit cards and Credit cards:**

Debit Card	Credit Card
Debit card is issued by bank account holder at the time of opening a savings or current account.	Credit card is issued at the discretion of issuer after satisfying himself of the credit worthiness of applicant.
Debit cards are used to withdraw money from ATM.	Money cannot be withdrawn through a credit card.
Debit card holder gets an e-statement on a regular basis.	Credit card holder gets monthly bill for its use.
Debit card is useless if the holder's account does not have the required balance.	Credit card extends credit for the holder and is not linked to any bank account.

KNOW THE TERMS

➢ **Business Finance:** It refers to the money employed in the business. It is the arrangement of cash and credit in the business at all times.

➢ **Financial Planning:** It is the process of estimating the funds requirement of a business.

➢ **Capital Structure:** It means the proportion of debt and equity used for financing the operation of business.

➢ **Fixed Capital:** If refers to the funds required for acquisition of fixed assets.

➢ **Working capital:** It is that part of total capital which is required for purchasing current assets.

➢ **Equity Shares:** Equity shares are those shares which are paid dividend only when profits are left after the preference shareholders are paid dividend.

➢ **Preference shares:** These are those shares which carry the following two rights:

   (i) They have right to receive dividend first.

(ii) They have right to get back their amount of capital at the time of winding up of the company before equity shareholders.

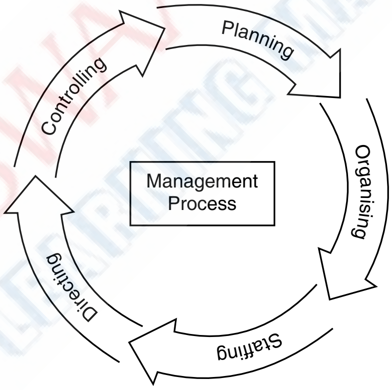
- **Right Shares:** These shares are offered to the existing shareholders after the formation of one year or first allotment.
- **Employee stock option Plan:** It is a scheme under which an employee of the company is given a right to purchase a specified number of shares at a particular price.
- **RTGS:** Real time gross settlement is a system of transfer of funds from one bank to another bank on real time basis.
- **NEFT:** National electronic fund transfer is a system of transfer of funds from one bank branch to another.
- **E-Banking:** It means banking transactions carried out with the help of computer system.
- **Tele banking:** Under this system the personal computer of a customer is linked by telephone to the bank's computer to get the account information.

❑❑

Chapter- 3 : Management Concept, Nature and Significance

REVISION NOTES

- **Meaning-concept of management:** Management is essential for all organizations big or small, profit or non-profit. Management is necessary so that individual may make their best efforts towards group objectives. According to the modern concept, management is a process of getting things done through others with the aim of achieving goals effectively and efficiently.
- **Modern Definition insists on:**



(1) Management as a process: Management is a process which that denotes the functions that managers perform to get things done. These functions include planning, organising, staffing, directing and controlling.

(2) Management as a discipline: The term 'management' has been used to denote neither the activity nor the personnel who perform it, but as a body of knowledge, a practice and a discipline. Here management refers to the principles and practices of management as a subject of study.

(3) Management as a group: Management has become a very common term. People use the term 'management' to denote a *team or group of managers who run an organisation.* Management of an enterprise is represented by the group of people which performs managerial functions for the accomplishment of its goals. These people are individually known as '*Managers*'.

(4) Management as an Activity: Like various other activities performed by human beings such as writing, playing, eating, cooking etc., management is also an activity because a manager is one who accomplishes the objectives by directing the efforts of others.

According to ***Koontz***, *"Management is what a manager does"*.

- **Objectives of Management:** The main objectives of management are as follows:

(1) Profitability: Management must make sure that the firm is earning sufficient profits to meet its different needs. It is necessary for the survival, growth and expansion of the business.

(2) **Quality goods at fair prices:** Management should provide quality goods at reasonable prices. For this purpose, management has to reduce costs by stopping the wastage of materials.

(3) **Rightful decision-making:** Right decision at right time is an important part of management for the success of an organisation.

(4) **Change and Innovation:** An organisational environment is dynamic so it is changing day by day. Management should aim at technological and other innovations so that the organization can face the challenges successfully.

(5) **Discipline and morale:** Management helps in improving discipline in the organisation with the help of authority, responsibility and control process, it motivates people through monetary and non-monetary incentives.

➢ **Characteristics of management:** The basic features or characteristics of management are as follows:

(1) **Management is Goal-oriented:** The purpose of management is to achieve the goals of the organisation. For instance, management of a business aims at satisfaction of customers, earning of profits and increasing the goodwill and image of the business. The success of management is judged by the extent to which organisational goals are achieved.

(2) **Management is all Pervasive or Universal:** Management is essential for effective performance of any organised activity. Thus, it is universal in nature.

(3) **Management is a Continuous Process:** Management is a continuous process, *i.e.*, its functions are repeated time and again. Management does not stop anywhere. It is an ongoing process of planning the activities and execution of plans through organising, staffing, directing and controlling.

(4) **Management is a Group Activity:** Management is an integral part of any group activity. It is essential to undertake any organised activity. It involves the use of group efforts in the pursuit of well defined goals or objectives. It requires team work and coordination of efforts of group members for the achievement of organisational goals. Managers representing production, finance, marketing and human resource departments of the business work as a team to accomplish the business objectives.

(5) **Management is a Dynamic Function:** Managers continuously monitor the changes in the social, economic, political and legal environment. They make necessary changes to deal with the changing environment. In fact, management of change has become an important function of the management of dynamic organisations. In order to be successful, the management must change its goals and plans according to the needs of the environment.

(6) **Management is a Science as well as an Art:** Management has an organised body of knowledge consisting of distinct concepts, principles and techniques which have wide application. So it is treated as a science. The application of these concepts, principles and techniques requires specialised knowledge and skills on the part of the manager. Since the skills acquired by a manager are his personal possession, management is viewed as an art. The skills can be learnt through training and experience.

(7) **Management is intangible:** Management is intangible. It can be felt in the form of result but not seen. For example, when we are not able to produce the desired quantity, we say it is the result of poor management.

➢ **Nature of management:** The nature of management can be analysed in terms of art, science and profession.

➢ **Management as an art due to following reasons:**

(1) **Personal Skill:** Management is an art as in it one has to use his personal skill and knowledge in solving many complicated problems to achieve the enterprise objectives. It is an art of dealing with people to accomplish desired results. It is personalised like most arts in the sense that every manager has his own method of doing the things. Hence, there are differences in the performance of different managers inspite of their possessing equal technical qualifications.

(2) **Practical Knowledge:** Just as a person cannot be called a musician even if he knows the technicalities of music unless he plays musical instruments similarly a person cannot be called a manager even if he learns by heart the principles of management unless he can apply these principles in practice while taking managerial decisions. Management does not merely mean the knowledge but practice which makes it effective and useful.

(3) **Regular-oriented approach:** Management aims at achieving maximum productivity at lowest costs. It is concerned with accomplishment of objectives. In this sense it is a result-oriented approach. It has to ensure that, projects are completed in time, targets of production and sales are achieved, a fair return on capital investment is secured and so on.

(4) **Regular Practice:** One cannot be a good manager unless he regularly practice this art of decision-making and leadership. As an artist, the manager always tries to attain higher and higher goals in order to reach the stage

of absolute perfection. This efficiency and effectiveness is attained through regular practice. An experienced manager moulds the enterprise according to the changed situations and also alters the environment itself.

(5) Creativity: Management is one of the most creative art as it is concerned with getting work done through others by motivating them to work and by co-ordinating their activities.

- **Management as a Science due to following reasons:**

(1) Systematised body of knowledge: As a science management is an organised body of knowledge built up by management practitioners, thinkers and philosophers over a period of years. Management science is a body of systematised knowledge accumulated and accepted with reference to the understanding of general truths concerning management.

(2) Use of scientific methods: The process of management makes use of scientific methods for observation. Frederick W. Taylor, the Father of Scientific Management applied scientific techniques to studies of planning, organising, staffing, motivating, etc.

(3) Continued observation: The principles of management have been developed after continued observation. The knowledge of management has principles that have universal application. The knowledge of management has been accumulated and accepted with reference to general truths. Hence, there are certain fundamental principles of management which can be universally applied.

- **Management as a profession: Management is profession due to following reasons:**

(1) Body of specialised knowledge and techniques: Management is an organised body of knowledge build up by management practitioners, thinkers and philosophers over a period of years. In this sense, modern management is certainly a profession. A.P.M. Fleming has rightly remarked that modern management is "a technique quite apart from the technology of the particular works concerned."

(2) Formalised methods of acquiring training and experience: Today, the management science is fully equipped with formalised methods of acquiring the body of knowledge in theory and practice. A larger number of formal institutes in the various countries, including India impart management education and training. Several tools of management have been developed such as Business Psychology, Business Law, Statistics, Data-processing, Operation Research and Cost Accounting, etc. Today, the business houses prefer to employ those managerial personnels who have obtained a professional degree in management from some recognised institute.

(3) Establishment of professional associations: Professional Management Associations are being established in most of the countries to (i) regulate the behaviour of members; (ii) to create a code of conduct for guiding the activities of the profession; and (iii) to promote and build up the image of management as a profession. In India, there is an All India Management Association. The main function of this association is to manage and co-ordinate the research work in the various areas of management. However, norms of managerial behaviour have not yet been established and there are no uniform methods of entry.

(4) Code of Conduct: Members of a profession have to abide by a code of conduct which provides rules and regulations, norms of honesty, integrity and professional morality. There exists a standard code of conduct in the traditional professions such as law and medicine. But there exists no uniform code of conduct in the sphere of management. There are no restrictions or licensing on the entry of management profession. Judged from these standpoints, management cannot be regarded as profession.

- **Importance of Management:** Peter F. Drucker refers to management as the ***dynamic life-giving element*** of every business enterprise. Management is the *thinking organ that provides vision to the business.* It is also the *integrating force* for the accomplishment of business objectives. The importance of management to a modern business is discussed below:

(1) Accomplishment of Organisational Goals: It is the management which determines the goals of the organisation and of various departments and functional groups. The goals are communicated to the employees to seek their cooperation.

(2) Efficient Utilisation of Resources: Management ensures efficient utilisation of resources to reduce costs and increase profits. Through planning and organisation, management eliminates all types of wastages and achieves efficiency in all business operations. Management motivates worker to put in their best performance. This would lead to the effective working of the business.

(3) Dynamic Organisation: Management establishes sound organisation for the accomplishment of the desired objectives. It clarifies authority-responsibility relationships among various positions in the enterprise. It fills various positions with persons having the right qualification and training. Management also provides the workers with proper environment and encourages the spirit of co-operation.

Management deals with integration of human and non-human resources in order to achieve organisational objectives. It directs and coordinates the activities of individuals and groups in the use of materials, methods and machines. It, thus, brings order to endeavours of different groups.

(4) Accomplishment of Personal Objectives: Management leads the group members to inspire them to achieve their personal objectives while working for the organisational objectives. Management helps them to satisfy their physical, social, and psychological needs so as to develop a cooperative and committed team.

(5) Development of Society: Efficient management of resources is equally important for the development of society. According to ***Peter Drucker***, "*Management is the crucial factor in economic and social development.*" The development of a country virtually depends upon the quality of management of its resources. Efficient management of resources helps in the development of nation in the following ways:

(a) provision of good quality products and services;

(b) creation of employment opportunities;

(c) technological innovations for the betterment of society; and

(d) contribution to economic growth and development.

(6) Vision and Foresight: Management keeps itself in touch with the external environment and provide vision and foresight to the enterprise. It helps in predicting what is going to happen in future which will influence the working of the enterprise. It also takes steps to ensure that the enterprise is able to meet the demands of changing environment.

KNOW THE TERMS

- **Management:** Management is a distinct process consisting of planning, organising, staffing and controlling.
- **Management as an activity:** It is an activity because it gets things done through others.
- **Management as a group:** Management of an enterprise is represented by the group of people which performs the managerial functions.
- **Management as a process:** It is a series of interrelated functions.
- **Management as a discipline:** It refers to principles and practices of management as a subject of study.

❑❑

Chapter- 4 : Principles of Management

REVISION NOTES

Concept of Principles of Management, Nature, Need/Importance of Principles of Management.

- **Concept of Principles of Management:** The principles of management are statements of fundamental truth which can be used by managers as guidelines for decision-making and action under different situations. Over the years, a number of management thinkers including Henry Fayol, F.W. Taylor and James D. Mooney have derived certain generalisation from their experience as managers. These generalisations were termed as principles of management.
- **Nature of principles of management:**

(1) Universal application: The principles of management are universal in nature, that means they can be applied to all types of organisations irrespective of their size and nature. Their results may vary and application may be modified but these are suitable for all kinds of organisations.

(2) General guidelines: Management principles are not static or absolute statements. These cannot be applied blindly in all the situations. The applicability of management principles depends on conditions and nature of organisation. The manager must apply these principles according to the size and nature of organisation keeping in mind the requirements of the organisations.

Management principles give guidelines to solve the problems. These principles do not provide readymade solution for all the problems.

(3) Flexibility: The principles of management are relative and not absolute. They are dynamic, not static. These principles should be applied carefully according to organisational needs and prevalent situations.

(4) Influence on Human Behaviour: The principles of management are meant for influencing human behaviour and getting higher performance from them. They guide them how to respond under different situations.

(5) Evolutionary/formed by practice and experiments: The management principles are developed only after deep and thorough research work. They are not developed overnight or they are not the personal feeling of any person. Proper observations and experiments are conducted before developing them. These are the expressions of deep experiences of leaders of management thoughts. Therefore, they are evolutionary in nature.

(6) Contingent: Management principles are contingent or dependent upon the situations prevailing in organisation. Their application and affect depend upon the nature of organisation. The application of principles has to be changed according to the nature, size and type of organisation.

- **Need of Principles of Management:** The need and significance of management principles arises because of the following reasons:

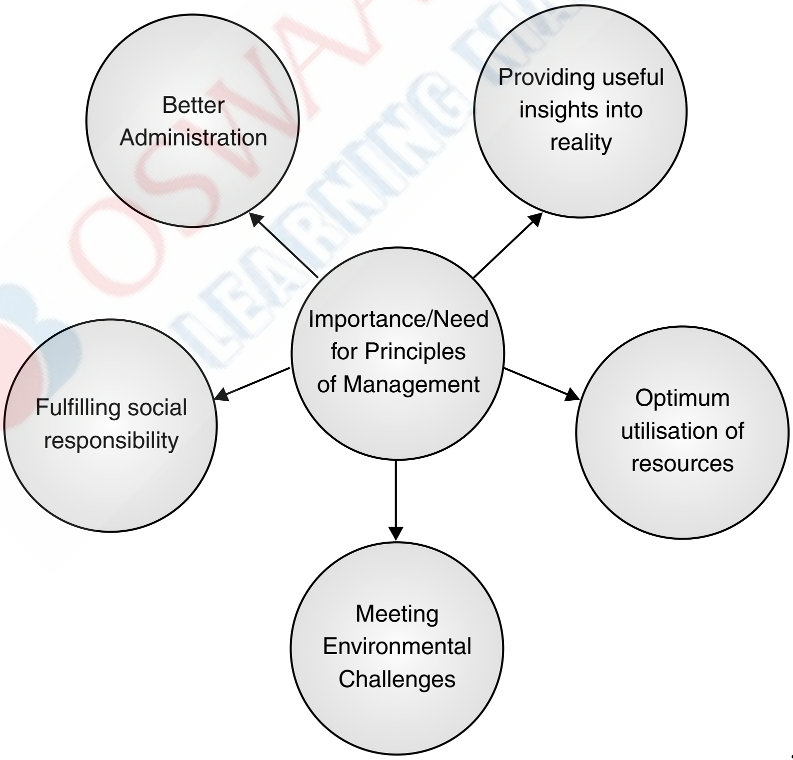
(1) Providing Useful Insights into Reality: The knowledge of management principles makes it easy to analyse the manager's job and define the scope of his duties. The nature of management can be clearly highlighted by properly understanding the principles. It is through the application of management principles that a manager can deal with complex business problems.

(2) Optimum utilisation of resources: The management principles insists on planned activities and systematic organisation of men and materials in the organisation. Principles are designed to get maximum benefits from the human efforts and other resources.

(3) Meeting Environmental Challenges: Every business operates in a dynamic environment. Changes in economic, social, political, technological and legal environment create challenges for the business. The managers can apply the management principles suitably to deal with different kinds of situations. They need to be flexible and careful in dealing with various environmental challenges.

(4) Fulfilling Social Responsibility: Management itself is a part of society and it takes inputs from the society and supplies output to the society. If the management is efficient, the resources of the society will be better utilised. Better products at lower prices will be made available to the society. This will improve the quality of life of the people. Management principles have an important role in developing efficient managers who will work for social objectives.

(5) Better Administration: Proper understanding of the principles of management helps the managers in formulation of effective plans and policies.



Taylor's Principles of Scientific Management, Fayol's Principles of Management

- **Taylor's Principles of Scientific Management:** F.W. Taylor laid the foundations of management as a science consisting of fundamental principles. He was the expert to suggest the use of scientific methods. Therefore, Taylor is known as the "father of scientific management".

"Scientific management is the art of knowing exactly what you want your men to do and then seeing that they do it in the best and cheapest way". *—F.W Taylor*

The basic principles of scientific management are as follows:

(1) Science, not Rule of Thumb: This principle requires development and application of scientific methods. Taylor advocated that the traditional' rule of thumb' methods should be replaced with the scientific methods.

(2) Harmony not Discord: There should be healthy cooperation between employer and employees. Taylor advocated a complete mental resolution on the part of both management and workers.

(3) Maximum not restricted output: Conflict between management and workers should be avoided. Both have a common interest in increasing productivity.

(4) Division of Work and Responsibility: Taylor suggested separation of planning from operational work. Management should concentrate on planning the job of workers and workers should concentrate on performance of work.

(5) Scientific Selection, Training and Development of Workers: Workers should be selected and trained keeping in view the job requirements. Each and every worker should be encouraged to develop his full potential.

➢ ***Fayol's* Principles of Management**

Background and History of *Fayol*

Henry Fayol was born in France in 1841. He got degree in mining engineering in 1860 and started working as engineer in a coal mining company. In 1888, he was promoted as the managing director of the company. At that time the company was in the situation of insolvency. He accepted the challenge and applied his managerial techniques to bring out the company from this situation and he succeeded. When he retired after 30 years the company was a leading coal-steel company with strong financial background.

Principles of Management Developed by *Fayol*

(1) Division of Work: According to this principle the whole work must be divided into small units and instead of assigning the whole work to one person one unit of work should be assigned to one person according to the capability, qualification and experience of the person.

(2) Authority and Responsibility: Authority means power to take decision. Responsibility means obligation to complete the job assigned on time. According to this principle, authority without matching responsibility may bring negative results and excess of responsibility without matching authority will not allow the worker to complete his job on time. There is need to bring parity between both for best results.

(3) Discipline: Discipline refers to general rules and regulations for systematic working in an organisation. Discipline does not mean only rules and regulations but it also means developing commitment in the employees towards organisation as well as towards each other. ***Fayol*** insists that discipline is required at superior as well as subordinate level.

(4) Unity of Command: According to this principle an employee should receive orders from one boss only because if he is receiving orders from more than one boss then he will get confused and will not be able to understand that whose orders must be executed first.

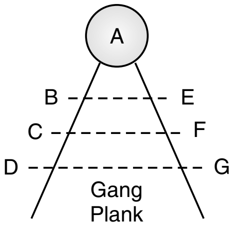
(5) Unity of direction: There should be one head and one plan for a group of activities having the same objective. In other words, each group of activities with the same objective must have one plan of action and must be under the control of one superior. Without unity of direction unity of action and coordination of efforts are not possible.

(6) Subordination of Individual Interest to General Interest: The business enterprise is superior to its individual employees. The interests of the business organisation must prevail upon the personal interests of the individuals. This principle calls for reconciliation of goals of individuals with those of the organisation.

(7) Remuneration of Persons: According to this principle employees in the organisation must be paid fairly or adequately to give them maximum satisfaction. The employees should be paid fair wages and salaries, which would give atleast a reasonable standard of living.

(8) Centralisation and Decentralisation: Centralisation refers to concentration of authority of power in few hands at the top level. Decentralisation means evenly distribution of power at every level of management. According to ***Fayol*** a company must not be completely centralised or completely decentralised but there must be combination of both depending upon the nature and size of the organisation.

(9) Principle of Scalar Chain: Scalar chain means line of authority of chain of superiors from highest to lowest rank. ***Fayol*** insists that this chain must be followed strictly in the organisation. Every information must pass through every key of this chain, no skipping of any one key should be allowed.



According to scalar chain principle if E wants to contact O he has to move through E — D — C — B — A — L — M — N and O. If this chain is broken then there are chances of communication gap in the organisation but sometimes following scalar chain becomes a long process and if some important information has to be passed, it gets delayed. So in case of emergency and urgent information, ***Fayol*** permitted a short cut in the chain which is called "*Gang-Plank*". Gang-plank permits direct communication between the employees working in different position without following the scalar chain.

(10) Order: There must be material and social order in an enterprise. Material order implies "a proper place for everything and everything in its right place." Similarly, social order means "a place for everyone and everyone in his appointed place". The right man in the right job is very important for the successful functioning of an organisation.

(11) Principle of Equity: Equity refers to kind, fair and just treatment to employees. Employees will put their maximum efforts only when they are treated with kindness and justice. If a manager is biased in dealing with employees then employees will get dissatisfied and will not contribute to their maximum capacity.

(12) Stability of tenure: Reasonable security of service should be provided to all employees. Stability of tenure helps to develop loyalty and attachment on the part of employees.

(13) Initiative: Employees at all levels should be encouraged to think out and execute the assigned tasks in a better way. Initiative is source of strength for an organisation. Therefore, subordinates should be inspired to suggest improvements in the formulation and implementation of plans.

(14) Esprit de Corps: Management must encourage and promote team spirit, unity and harmony. This will bring coordination in organisation. A manager should replace "I" with "We". This will give rise to mutual trust and belongingness among team members. It will minimise the need for using penalties.

KNOW THE TERM

➢ **Principles of Management:** Principles of Management are statements of fundamental truth which can be used by managers as guidelines for decision-making and action under different situations.

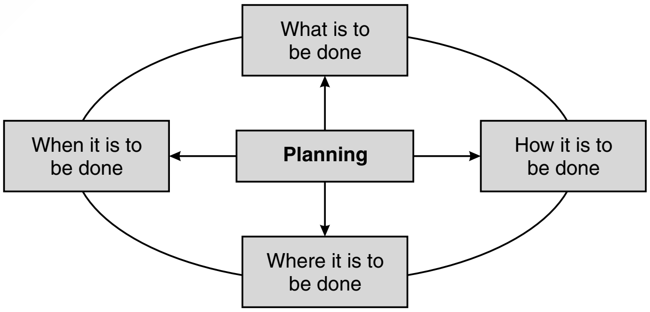
❑❑

Chapter- 5 : Functions of Management (Planning)

REVISION NOTES

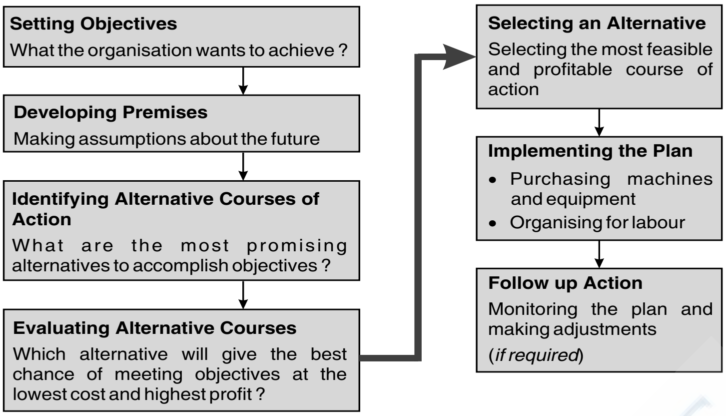
Meaning, Steps, Importance and Limitations of Planning

➢ **Planning:** It means setting objectives and formulating an action plan to achieve them. It includes deciding in advance-what to do, how to do and who is to do it.



➢ **Meaning of Planning: According to M.E. Hurely,** *"Planning is deciding in advance what is to be done"*. It involves the selection of objectives, policies, procedures and programmes.

➢ **Steps in Planning Process:** Planning process involves certain logical steps as shown in the diagram:



➢ **Process of Planning:**

(i) **Setting objectives:** Objectives are set for the entire organisation and its each department.

(ii) **Developing premises:** Assumptions about future events are established.

(iii) **Identifying alternative courses of action:** All the alternative courses of action are identified.

(iv) **Evaluating alternative courses:** The positive and negative aspect of each alternative is evaluated.

(v) **Selecting an alternative:** The most feasible, profitable and with least negative consequences alternative is selected as plan.

(vi) **Implementing the plan:** The selected plan is put into the action.

➢ **Importance of Planning**

(i) **Provides directions:** By stating in advance how the work is to be done.

(ii) **Reduces the risks of uncertainty:** By looking ahead, anticipating changes and developing managerial responses to them.

(iii) **Reduces overlapping and wasteful activities:** By coordinating the activities and efforts of different divisions, departments and individuals.

(iv) **Promotes innovative ideas:** By intelligent application of mind and imagination and farsightedness to make a concrete plan.

(v) **Facilitates decision making:** By making a choice amongst the alternative courses of action.

(vi) **Establishes standards for controlling:** Against which actual performance is measured.

➢ **Features of Planning**

(i) **Planning focuses on achieving objectives:** It defines objectives and prepares action plan to achieve them.

(ii) **Planing is primary function of management:** It lays down the basis for all other functions of management.

(iii) **Planning is pervasive:** It is required in all organisations, at all levels and in all departments.

(iv) **Planning is continuous:** Once a plan is framed and implemented, it is followed by another plan and so on.

(v) **Planning is futuristic:** It involves looking ahead and preparation for the future.

➢ **Limitations of Planning**

(i) **Leads to rigidity:** Once a plan is drawn, the managers may not be in a position to change it.

(ii) **May not work in a dynamic environment:** It is difficult to assess future trends accurately, which is essential for effective planning.

(iii) **Reduces creativity:** Middle level and lower level managers have to just implement the plans framed by top management without any deviations.

(iv) **Involves huge costs:** Cost is incurred on discussion with professional experts for preliminary investigation, etc.

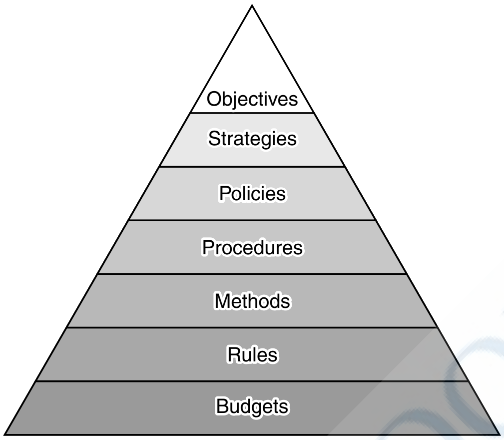
(v) **Time-consuming:** A lot of time is consumed in the collection and analysis of data, choice of alternative, etc.

(vi) **Planning does not guarantee success:** Previous successful plans may not work again in the future. It is not a solution to all the problems.

Different Types of Plans

- **Different types of plans are as follows:**

1. Objectives	**2.** Strategy	**3.** Policies	**4.** Procedures
5. Methods	**6.** Rules	**7.** Programmes	**8.** Budgets



1. **Objectives:** Objectives are the ends towards which the activities are directed. They are the end result of every activity.
2. **Strategy:** A strategy is a comprehensive plan to achieve the organisational objectives.
   The dimensions of strategy are:
   (a) Determining long term objectives.
   (b) Adopting a particular course of action.
   (c) Allocating resources for achieving the objectives.
3. **Policies:** Policies are the guiding principles which govern action usually of routine and repetitive nature. They are general statements which guide thinking and action of the organisational members.
4. **Procedures:** Procedures are required steps established in advance to handle future conditions. The sequence of steps to be followed by employees in different situations must be predetermined so that everyone follows same steps. The procedure can be defined as the exact manner in which an activity is to be accomplished.
5. **Methods:** Methods can be defined as formalised or systematic way of doing routine or repetitive jobs. The managers decide in advance the common way of doing a job.
6. **Rules:** Rules are specific regulations which must be followed by the employees in an organisation. Rules serve as boundaries of behaviour. They are specific statements telling the employees what must or must not be done.
7. **Program:** A Programme is a concrete scheme of action worked out by the management to accomplish certain objectives. A programme is action based and result oriented. It provides practical guidelines to managerial activities.
8. **Budgets:** A budget is a single-use plan since it is prepared for a particular period of time. A budget is a statement of expected results expressed in quantitative terms. Since it is a statement of expected results, it is also used as an instrument of managerial control.

KNOW THE TERMS

- **Planning:** It is the process of deciding in advance what is to be done.
- **Process of planning:** It includes setting objectives, developing premises, identify course of action, evaluating alternative courses, selecting and implementing the plan.
- **Planning:** It means setting objectives and targets and formulate an action plan to achieve them.
- **Strategy:** A comprehensive plan to achieve the organisational objectives.
- **Policy:** General statements that guide thinking in decision making.
- **Procedure:** Guide to action and are expressed in specific terms.
- **Rule:** Specific regulations which must be followed by the employees.
- **Budget:** A statement of expected result expressed in quantitative terms.

❑❑