

**Paper 1 – Fundamentals of Economics
and Management**

Answer to MTP_Foundation_Syllabus 2016_June 2018_Set 1

Paper 1 – Fundamentals of Economics and Management

Full Marks: 100

Time allowed: 3 hours

The figures in the margin on the right side indicate full marks.

This question paper has two sections.

Both the sections are to be answered subject to instructions given against each.

Section A (50 marks)

I. Choose the correct answer from the given four alternatives:

[20 × 1 = 20]

(1) Who defined economics as " science which deals with wealth"

- (a) **J. B. Say**
- (b) A.C. Pigou
- (c) Alfred Marshall
- (d) Robbins

(2) Macro Economics theory deals with.

- (a) **Economy as a whole**
- (b) Individual units
- (c) Economic growth
- (d) all the above

(3) _____ tells us the rate of change in demand.

- (a) **Elasticity of demand**
- (b) Consumption analysis
- (c) Demand analysis
- (d) Consumer surplus

(4) Point elasticity was propounded by

- (a) Adam Smith
- (b) **Marshall**
- (c) Robbins
- (d) Keynes

(5) Scarcity of resources leads to

- (a) Un-satisfaction of human wants
- (b) Evaluation of alternative uses of scarce resources
- (c) **Both**
- (d) None

(6) Ceteris Paribus means

- (a) Holding demand constant
- (b) Holding supply constant
- (c) Price being constant
- (d) **Other thing being constant**

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- (7) An increase in price will result in an increase in total revenue if _____
- (a) Percentage change in quantity demanded is greater than the percentage change in price
 - (b) Percentage change in quantity demanded is less than the percentage change in price**
 - (c) Percentage change in quantity demanded is equal to the percentage change in price
 - (d) None of the above
- (8) Returns to a variable factor operates in _____
- (a) Short run**
 - (b) Long run
 - (c) either 'a' or 'b'
 - (d) neither 'a' nor 'b'
- (9) Select the quantitative credit control method from the following alternatives:
- (a) Moral suasion
 - (b) Open market operations**
 - (c) Rationing of credit
 - (d) Licensing of branches
- (10) Which of these will have highly inelastic supply
- (a) Perishable goods**
 - (b) Consumer durables goods
 - (c) Item of elite class consumption
 - (d) All the three
- (11) Economic resources are
- (a) Unlimited
 - (b) Limited in supply and use
 - (c) Limited in supply but have alternative uses.**
 - (d) Unproductive
- (12) In the long run a firm in perfect competition earns
- (a) Normal profit only**
 - (b) Abnormal profit
 - (c) Average profit of past five years
 - (d) 12.33% profits on capital employed
- (13) The famous book "An enquiry into the nature and causes of wealth of Nation" was published in-
- (a) 1776**
 - (b) 1750
 - (c) 1850
 - (d) 1886

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- (14) Total output is maximum when
 (a) **MP =0**
 (b) MP is increasing
 (c) MP is decreasing
 (d) MP is constant
- (15) Law of variable proportion applies.....
 (a) When all inputs are variable
 (b) When all inputs are fixed
 (c) **Some inputs are fixed and some are variable**
 (d) All the three
- (16) Which of these would lead to fall in demand for money?
 (a) Inflation
 (b) Increase in real income
 (c) **Increase in real rate of interest**
 (d) Increase in wealth
- (17) Implicit cost refers to
 (a) Value of inputs owned by the firm and used in its own manufacturing process.
 (b) Value of input or services purchased from outside and used in its own manufacturing process
 (c) Value of inputs owned by the firm and sold to others
 (d) **Value of inputs or services for which no payments were made to outside**
- (18) _____ is a qualitative credit control instrument used by the Central Bank.
 (a) Bank Rate Policy
 (b) **Moral Suasion**
 (c) Open Market Operations
 (d) CCR
- (19) Financial markets are classified into Money Market and
 (a) Bullion Market
 (b) **Capital Market**
 (c) Stock Market
 (d) National Market
- (20) Which of these is near money?
 (a) Bills of exchange
 (b) Savings Bond
 (c) Gilt edged securities
 (d) **All of these**

II. Match the following

[5 x 1 = 5]

	Column 'A'		Column 'B'
1	Commercial Banks	A	Other things being constant
2	Durable Goods	B	Adam Smith
3	Ceteris paribus	C	Acceptance of Deposits
4	Creation of Utility	D	Inelastic Demand
5	Father of Economics	E	Production

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Answer:

	Column 'A'		Column 'B'
1	Commercial Banks	C	Acceptance of Deposits
2	Durable Goods	D	Inelastic Demand
3	Ceteris paribus	A	Other things being constant
4	Creation of Utility	E	Production
5	Father of Economics	B	Adam Smith

III. State whether the following statement is True (or) False.

[5 x 1 = 5]

1. In perfect market $AR < MR$
2. Human wants are unlimited.
3. Perfectly Elastic Supply Curve is parallel to "X" axis.
4. According to Fisher – Money is demanded for Transaction purpose.
5. Collateral loans are given by Commercial Banks without security.

Answer:

1. False;
2. True;
3. True;
4. True;
5. False

IV. Answer any four of the following

[4×5 = 20]

1. State the determinants of demand.

Answer:

Determinants of demand:

The demand for any commodity is depend upon so many factors. These factors are called determinants of demand. They are:

- a. Price of the goods: The demand for any commodity firstly depends upon its price. When the price rises demand decreases, when the prices falls demand increases.
- b. Prices of the substitute goods: The demand for any commodity not only depends upon its price but also the prices of its substitute goods. For example, tea and coffee. Here the demand for tea depends upon price of the coffee.
- c. Prices of the complementary goods: The demand for a commodity also depends upon the price of its complementary goods. For example, car and petrol. Here demand for petrol depends upon price of the car.
- d. Income of the consumer: The income of the consumer also influences the demand for a commodity. When the income rises people purchase the more quantity of goods. When the income falls they purchase less quantity of goods.
- e. Tastes and preferences of the consumer: The tastes and preference of the consumer can also determine the demand for a commodity. When the tastes are changed, the demand for goods also changed.
- f. Population: When the population is increased, the demand for goods also increases. When the population decreases demand also decreases.

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- g. Climate: The climatic conditions also can influence the demand. In hot climatic conditions cool drinks are demanded. In rainy season umbrellas are demanded.

2. Explain "Return to Scale".

Answer:

It shows the relationship between inputs and outputs in the long period. The change in the quantity of the factors is called scale. Change in the output is called returns. So law of returns to scale explains changes in the output due to changes in the inputs in the long period.

Explanation of the law: According to this law when all inputs are increased in same proportions when the output is not increased in the same proportion. The changes in the output are classified in to three stages. They are

- Increasing returns to scale
- Constant returns to scale
- Diminishing returns to scale

Scale of production	Inputs (Land + Labour)	Total productivity	Marginal productivity
A	1+2	4	4
B	2+4	10	6
C	3+6	18	8
D	4+8	28	10
E	5+10	38	10
F	6+12	48	10
G	7+14	56	8
H	8+16	62	6
I	9+16	66	4

In the above table all inputs are changed in equal quantities or scale is changed. Changes in output can be observed from total and marginal returns output changes are clearer from the marginal returns. In the beginning when inputs are doubled marginal returns are more than doubled. Such a change in output is called increasing returns. But in the third and fourth combinations output has increased in the same proportion. Hence, there are constant returns later similar change in inputs are giving diminishing returns.

3. Explain "Opportunity Cost".

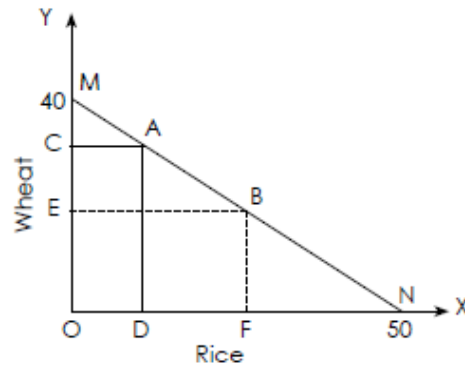
Answer:

The opportunity cost of anything is next best alternative cost which is forgone. Individual point of view (or) nation point of view the resources are scarce. At that time to get the one commodity we have to forgo the another commodity. This is called opportunity costs.

Suppose a price of land can be used for growing wheat or rice. If the land is used for growing rice, it is not available for growing wheat. Therefore the opportunity cost for rice is the wheat crop foregone.

This is illustrated with the help of the following diagram.

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Suppose the farmer, using a price of land can produce either 50 quintals (ON) of rice or 40 quintals (OM) of wheat. If the farmer produced 50 quintals of rice (ON), he cannot produce wheat. Therefore the opportunity cost of 50 quintals (ON) of rice is 40 quintals (OM) of wheat. The farmer can also produce any combination of the two crops on the production possibility curve MN. Let us assume that the farmer is operating at point A on the production possibility curve where he produces OD amount of rice and OC amount of wheat. Now, he decides to operate at point B on the production possibility curve. Here he has to reduce the production of wheat from OC to OE in order to increase the production of rice from OD to OF. It means the opportunity cost of DF amount of rice is the CE amount of wheat.

4. Enumerates the features of perfect competition.

Answer:

The perfect competition market has the following features.

1. Large number of sellers and buyers:

There will be a large number of sellers and buyers for a good in this market. It means the output of a buyer or a seller is a small part of the total output. A single producer or seller cannot change the price by his actions. None of them is large enough to influence the price. Therefore a seller takes the price decided by the market. The producer is a price taker.

2. Homogeneous Commodities:

Products in this market are similar in every aspect. A consumer gets the same good whenever he purchases. As a result there will be one price all over the market.

3. Free entry and exit:

Any firm can enter into the production as per its desire. Finally it can leave the production at any time. This helps new firms to enter into business when conditions are favourable. As long as a firm earns super normal profits, it usually stays in competition. But when the firm ends up with losses, it would leave the market.

4. Mobility of factors of production:

Factors of production will move from one production to another easily. This is also useful for free entry and exit of firms factors (land, labour, capital) move to the production activities where they get higher incomes.

5. Absence of transport cost:

Under perfect market transport costs should not be added in the price. If transport costs are added the goods are available at the fewer prices at the near markets and they are available at the higher prices at distant markets. Existing of two prices for the same thing in different parts is against for perfect market. So transport cost should not be added.

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6. Perfect knowledge of market:

Buyers and sellers in this market will have a clear knowledge about market conditions. So that there will be one price throughout the market. Because of perfect knowledge, sales and purchases of commodities take place as one price.

5. Explain the function of Central Bank.

Answer:

A Central Bank has the following functions:

1. Note Issue:

The Central Bank alone is authorized to issue the currency notes in a country. It has the monopoly of note issue as no other bank is permitted to do so. It also enables the Central Bank to control the supply of money as per the requirements of the economy.

2. Banker to Government:

The Central Bank acts as a banker, agent and financial advisor to government in the following ways:

- (a) It maintains the accounts of the government funds.
- (b) It receives money and makes payments on behalf of the government.
- (c) It gives 'ways and means' advances to the government.
- (d) It issues new loans on behalf of the government.
- (e) It manages the public debt.
- (f) It undertakes foreign exchange transactions on behalf of the government.
- (g) It acts as the agent of the government in dealing with the international financial institutions like IMF and World Bank.
- (h) It advises the Government on all financial matters.

3. Banker's Bank:

The Central bank acts as a banker's bank in the following manner.

- (a) Every bank maintains a certain minimum of cash reserves with the Central Bank as a statutory obligation.
- (b) It serves as a lender of last resort. This helps the commercial banks to overcome the problems of liquidity and will be able to meet the demand for withdrawals even in times of financial stringency.
- (c) It acts as a clearing house for the commercial banks to settle their inter-bank accounts. This is possible because all commercial banks have account with the Central Bank in which the Central Bank keeps their cash balances.

4. Lender of last resort:

The Central Bank serves a lender of last resort not only to commercial banks but also to discount houses, and other credit institutions. They may approach the central bank when they face the problem of liquidity.

5. Controller of credit:

This is the most important function of the Central Bank. It controls the volume of credit in the economy through appropriate monetary policy. It takes steps to reduce the credit in case of inflation.

6. Custodian of foreign exchange reserves:

The Central bank maintains the reserves of foreign exchange and regulates their use. It has the responsibility to maintain the stability of the exchange rate of the native currency in terms of the foreign currency.

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6. Explain the measures to improve the Indian Money Market.

Answer:

Measures to Improve Indian money market:

In view of the various defects in the Indian money market, the following suggestions have been made for its proper development:

- (i) The activities of the indigenous banks should be brought under the effective control of the Reserve Bank of India.
- (ii) Hundies used in the money market should be standardized and written in the uniform manner in order to develop and all-India money market.
- (iii) Banking facilities should be expanded especially in the unbanked and neglected areas.
- (iv) Discounting and rediscounting facilities should be expanded in a big way to develop the bill market in the country.
- (v) For raising the efficiency of the money market, the number of the clearing houses in the country should be increased and their working improved.
- (vi) Adequate and less costly remittance facilities should be provided to the businessmen to increase the mobility of capital.
- (vii) Variations in the interest rates should be reduced.

Section B (50 marks)

I. Choose the correct answer from the given four alternatives:

[20 × 1 = 20]

- (1) _____ involves the selection of language in which the message is to be given.
 - (a) Medium
 - (b) Decoding
 - (c) Encoding**
 - (d) Feed back

- (2) Formal communication is always
 - (a) Written**
 - (b) Oral
 - (c) Both „a“ and „b“
 - (d) None of the above

- (3) The last, but not least important principle of direction is
 - (a) Unity of command
 - (b) Follow up**
 - (c) Direct supervision
 - (d) Appropriate Leadership Style

- (4) Which one is not a barrier to communication?
 - (a) Filtering
 - (b) Emotions
 - (c) Message**
 - (d) Language

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- (5) The process of communication starts with _____
- (a) Supervisor
 - (b) Sender**
 - (c) Receiver
 - (d) None of the above
- (6) _____ is a kin to 'nucleus' of an organization.
- (a) Supervision
 - (b) Planning
 - (c) Direction**
 - (d) Organising
- (7) _____ is aimed at maintaining harmony among employees and groups in an organisation
- (a) Direction**
 - (b) Supervision
 - (c) Planning
 - (d) Control
- (8) What activity enables the managers to distribute their work load to others?
- (a) Centralisation
 - (b) Decentralisation
 - (c) Delegation of authority**
 - (d) None of the above
- (9) Manpower planning is also known as _____
- (a) Human Resource Accounting
 - (b) Human Resource Management
 - (c) Human Resource Planning**
 - (d) None of the above
- (10) Delegation helps to improve the job satisfaction, motivation and morale of _____
- (a) Subordinates**
 - (b) Superiors
 - (c) Peers
 - (d) None of the above
- (11) _____ are related to the maintenance of successful relationship between peers and subordinates.
- (a) Decision making skills
 - (b) Interpersonal skills
 - (c) Operative skills
 - (d) All of the above**
- (12) _____ is concerned with providing the organization with the right number of people, at the right place and at the right time so that the organization would be able to achieve its goals effectively.
- (a) Recruitment
 - (b) Staffing**
 - (c) Selection
 - (d) Development

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- (13) Concentration of authority at the top level of the organization is known as ____
- (a) **Centralisation**
 - (b) Decentralisation
 - (c) Delegation of Authority
 - (d) Responsibility
- (14) Control function is closely connected to _____
- (a) **Planning**
 - (b) Organising
 - (c) Coordination
 - (d) All of the above
- (15) Control system follows the following sequence:
- (a) **Establishment of standards – Measurement of actual performance – Comparing the actual performance with standards – Take corrective action.**
 - (b) Establishment of standards – Measurement of actual performance – Take corrective action – Comparing the actual performance with standards.
 - (c) Establishment of standards – Comparing the actual performance with standards – Measurement of Actual performance – Take corrective actions – None of the above.
 - (d) None of the above
- (16) Decentralisation suffers from the following limitation.
- (a) Relief to top executive
 - (b) **Expensive**
 - (c) Quick decision
 - (d) Executive development
- (17) Post control is also known as _____
- (a) **Feedback control**
 - (b) Concurrent Control
 - (c) Pre-control
 - (d) Fast forward control
- (18) Strategic decisions are made at which level.
- (a) Middle level
 - (b) Lower level
 - (c) **Top Level**
 - (d) At all levels
- (19) Assignment of duties is meaningless unless adequate authority is given to _____.
- (a) **Subordinates**
 - (b) Peers
 - (c) Superiors
 - (d) All of the above
- (20) The message to be transmitted through verbal medium may be
- (a) Orders
 - (b) Instructions
 - (c) Reports
 - (d) **All of the above**

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II. Match the following

[5 x 1 = 5]

	Column 'A'		Column 'B'
1	Break even analysis	A	Recognition and Status
2	Non Financial Rewards	B	Flows downward
3	Delegation of Authority	C	Laissez Fair Leadership
4	Theory X and Theory Y	D	Cost Volume Profit
5	Free-rein	E	Prof. Douglas McGregor

Answer:

	Column 'A'		Column 'B'
1	Break even analysis	D	Cost Volume Profit
2	Non Financial Rewards	A	Recognition and Status
3	Delegation of Authority	B	Flows downward
4	Theory X and Theory Y	E	Prof. Douglas McGregor
5	Free-rein	C	Laissez Fair Leadership

III. State whether the following statement is True (or) False.

[5 x 1 = 5]

1. Directing involves issuing orders to subordinates and supervises how these orders are carried out by them and if necessary, motivate the employees for higher performance.
2. Likert suggested that System 4 is the ideal system towards which organizations should work.
3. Communication is an exchange of facts, ideas, opinions or emotions by two or more persons.
4. Responsibility chart is an important technique that can supplement the use of Role Negotiation.
5. Brain Storming is one of the participative techniques.

Answer:

1. True
2. True
3. True
4. False
5. False

IV. Answer any four of the following questions

[4x5= 20]

1. Fayol's fourteen Principles of Management

Answer:

In order to put into practice the elements of management, Fayol enunciated fourteen principles which should be applied carefully and selectively. They are explained below:-

- (1) Division of work – Division of work is necessary to enjoy the benefits of specialization.
- (2) Authority and responsibility – Authority means the power to give orders and to ask for obedience. Responsibility means the sense of dutifulness which is correlated with authority. There must be parity between the two.

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- (3) Discipline – The three requisites are necessary for maintaining discipline – (a) good supervisors, (b) clear and fair agreements and (c) proper application of sanctions or penalties.
- (4) Unity of Command – It means that one individual employee must receive orders from one individual superior only.
- (5) Unity of direction – One and same objective for the whole unit of organization and for that there should be one leadership and one plan.
- (6) Subordination of individual interest to general interest – Individual or group interest must be surrendered to general interest.
- (7) Remuneration – Remuneration should be fair and satisfactory to both the employees and the employer.
- (8) Centralization – By centralization there is optimum utilization of the available resources.
- (9) Scalar chain – It is the chain of superior existing from the highest authority to the lowest ranks.
- (10) Order – It means that inside an organization there should be a place for everything and everything in its place.
- (11) Equity – The sense of equity must prevail throughout all the levels of the organization and the management should see to it.
- (12) Stability of tenure of personnel – An employee needs time to get himself accustomed to a line of work and then he can show his ability. Therefore the personnel are stable.
- (13) Initiative – The initiative of the personnel must be roused at every level even by sacrifice of vanity by the managers.
- (14) Esprit de Corps – Teamwork is essential for the success of an organization.

2. Write a note on 'Span of Management'

Answer:

Span of Management also known as span of control, span of supervision or span of authority represents the numerical limit of subordinates to be supervised and controlled by a single supervisor. It is an important principle of building a sound organization. The principle is based on the theory of relationships propounded by Graicunas – a French management consultant who analysed the superior – subordinate relationship based on a mathematical formula.

No. of direct relationships = n

No. of cross relationships = $n(n-1)$

No. of group relationships = $n[2n - 1 - 1]$

Total No. of relationships = $n[2n/2 + (n-1)]$

Where n represents the number of subordinates.

The concept of span of management is central to the classical organization theory. Proper span of management is considered a necessity for effective supervision, co-ordination and control. It is therefore critical to determine the ideal span. If the span of control is narrow, there will be more organizational levels which in turn may impede communication. If the span is widened, the supervisory load may become too heavy. Thus, sound organization structure required striking an optimum balance between organization levels, and supervisory work load.

3. Need hierarchy theory

Answer:

Abraham H. Maslow, an eminent American psychologist, developed a general theory of motivation, known as the 'Need hierarchy theory'.

- (i) The urge to fulfill needs is a prime factor in motivation of people at work. Human beings strive to fulfill a wide range of needs. Human needs are multiple, complex and interrelated.
- (ii) Human needs form a particular structure or hierarchy. Physiological needs are at the base of the hierarchy while self-actualisation needs are at the apex. Safety (security) needs, social needs and esteem (ego) needs are positioned in between. As one proceeds from base towards apex, needs become less essential.
- (iii) Lower-level-needs must at least partially be satisfied before higher-level needs emerge. In other words, a higher-level need does not become an active motivating force until the preceding lower-order needs are satisfied. Human beings strive to gratify their needs in a sequential manner starting from the base of the hierarchy. All needs are not felt at the same time.
- (iv) As soon as one need is satisfied, another need emerges. This process of need satisfaction continues from birth to death. Man is a wanting animal.
- (v) A satisfied need is not a motivator, i.e., it ceases to influence human behaviour. It is the unsatisfied needs which regulate an individual's behaviour.
- (vi) Various need levels are inter-dependent and overlapping. Each higher level need emerges before the lower level need is completely satisfied.

4. Quantitative Techniques of Decision Making

Answer:

- (i) Linear programming: It is the technique for optimization of an objective function under given resources and constraints. The objective function is either maximisation of some utility or minimization of some disutility. The technique is useful under conditions of certainty.
- (ii) Probability decision theory: The basic premise of this theory is that the behaviour of the future is probabilistic and not deterministic. Various probabilities are assigned to the 'state of nature' on the basis of available information or subjective judgment and the likely outcomes of the alternative courses of action are evaluated accordingly before a particular alternative is selected. Pay-off Matrices and 'Decision Trees' are constructed to represent the variables.
- (iii) Game theory: It is a useful aid to the decision maker under conditions of competitive rivalry or conflict. The adversaries in the conflict are supposed to be involved in a game of gaining at the total or partial expense of each other. There are 'two-person', 'three-person' and 'n- person' games as also zero-sum and non-zero sum games.
- (iv) Queuing theory: The technique is designed to find solutions to waiting line problems for personnel, equipment or services under conditions of irregular demand. The objective is to find optimum volume of facilities to minimise the waiting period, on the one hand, and the investment associated with building up and maintaining the facilities, on the other. Public transport systems, hospitals, and big departmental stores are some of the possible users of this technique.

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- (v) Simulation: It is a technique for observing the behaviour of a system under several alternative conditions in an artificial setting. When the conditions of the environment are very complex and when it is not possible to find the one best way of doing things, it provides the manager a way out. The likely behaviour of events and variables is observed and evaluated in a simulated setting. It is possible to experiment with various possibilities or alternatives in a simulated setting rather than in a natural setting.
- (vi) Network techniques: There are two powerful network techniques—Critical Path Method (CPM) and Programme Evaluation and Review Technique (PERT) which are useful for project planning and control. Complex projects involve considerable cost and time. The objective is to minimize both by working out a 'critical path' where managerial attention is to be concentrated. A diagrammatic net-work of activities required for completion of a project is prepared in detail to assess their interrelation, to segregate sequential activities from simultaneous ones and to estimate the probable time and cost of their completion.

5. Methods of Training

Answer:

There are several methods of training. One important point to note here is that these methods of training are not competitive, rather they are complementary. Some of the most commonly used methods of training are —

- A. On-the-job training
- B. Off-the-job training

(A) On-the-job Training – Actually, training begins the first day when an employee starts his job. Every employee learns a lot on the job. On -the -job training is normally given by the superior or supervisor.

One notable feature is that there is no artificial location. Everything is a reality. The methods employed to make the on-the-job training are as under:

- coaching
- apprenticeship training
- job rotation
- vestibule training
- self-improvement programmes

(B) Off-the-job training – As the name itself indicates, off-the-job training refers to training conducted away from the actual work setting. Some of the popular methods of off-the-job training are:

- Lectures and classroom instruction
- The conference method
- Group discussions
- Role playing
- Case studies
- T-group training (or sensitivity training)

6. Types of Organisational Communication

Answer:

Communication may be of several types. On the basis of relationship between the parties communicating each other, the communication may be formal or informal. On the basis of flow of direction, communication can be downward, upward or horizontal.

(a) Formal and Informal Communication

Formal communication is the official message that is communicated by a manager by virtue of his position in the organisation structure. On the other hand, communication is said to be informal when it grown up spontaneously from personal and group interests.

(b) Downward, Upward and Horizontal Communication

When communication flows from top to bottom it is called downward communication, when it flows from bottom to up it is named as "upward communication". Lateral or horizontal communication refers to the flow of communication between various departments or people on the same level in an organisation.

(c) Verbal and Written Communication

Two methods of communicating a message may be verbal or written. Popular forms of oral communication include face-to-face talks, formal groups' discussions, and grapevine. On the other hand, written communication is a formal method of putting the orders, instructions, and reports in writing. It creates a record of evidence.