FOUNDATION

Paper 4

FUNDAMENTALS OF BUSINESS ECONOMICS AND MANAGEMENT

Study Notes

SYLLABUS 2022

The Institute of Cost Accountants of India

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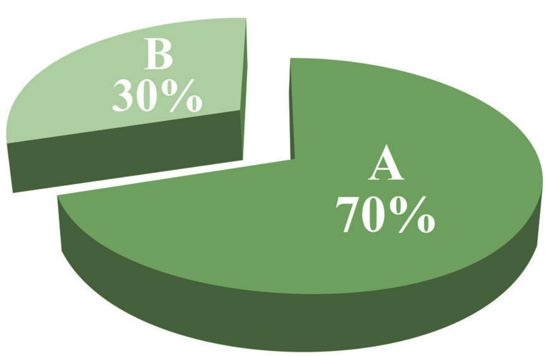
PAPER 4 : FUNDAMENTALS OF BUSINESS ECONOMICS AND MANAGEMENT

Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
	Section A: Fundamentals of Business Economics	**70%**
1	Basic Concepts	15%
2	Forms of Market	20%
3	Money and Banking	20%
4	Economic and Business Environment	15%
	Section B: Fundamentals of Management	**30%**
5	Fundamentals of Management	30%



Contents as per Syllabus

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SECTION - A

FUNDAMENTALS OF BUSINESS ECONOMICS

BASIC CONCEPTS 1

This Module includes:

BASIC CONCEPTS

Module Learning Objectives:

After studying this Module, the students will be able to –

- Develop an understanding of the fundamental concepts of Economics such as consumer's behaviour, producer's behaviour, utility, wealth and output generation.
- Attain in-depth knowledge of the law of demand and supply, concept of elasticity, equilibrium price and techniques of demand forecasting to facilitate marketing function in an organization.
- Appreciate the factors of production, law of variable proportion and law of returns to scale in the short term and long-term production planning respectively.
- Develop detail understanding of short run and long run behavior of total and average cost and their impact in managerial decisions.
- Acquire knowledge of various means of production.

Introduction

1

In this module, we will focus mainly on the demand analysis and cost analysis. This is because the business firms should have a clear idea of the market of its product through these two analyses.

Demand analysis determines the sales prospect of the business. So it has two important purposes (i) forecasting of sales and (ii) manipulation of demand. Production plans, inventory plans, investment plans, cash budgets, expansion of the firm – all depend on the volume of sales. Particularly this is important for a business firm which has seasonal fluctuations in its product demand.

Again, sales depend on advertisement, price policy, product improvement plans. Since these are within the control of the business firm, demand can be manipulated.

The cost analysis is important for the business firm because the estimation of cost is crucial for the firm to plan out production, investment and finally the plant size. For cost estimation, the firm can use multiple regression analysis by using the equation

$$C = a + bX_1 + cX_2 + u$$

Where, C is total cost of production, X_1 is the level of output and X_2 is the plant size, and U is the factor which captures the effects of other omitted variables explaining cost of production.

By estimating the three parameters a, b, and c, we can estimate the change in C per unit change in one independent variable (say, X_1), when the other independent variable (X_2) is held constant.

The Fundamentals of Economics 1.1

What is Economics?

Economics is one of the social sciences. It explains about the economic activities of a man. Any activity which is related to earning of the money and spending of the money is called economic activity. Almost all people are engaged in economic activities, because they want to earn the money.

The main economic problem is to transform society's resources into consumable commodities by using productive technology. It is a problem because human wants are unlimited and society's resources are limited. So the central task of economics is to decide how much of which commodities are to be produced for the optimum satisfaction of human wants. The firms and the households are the basic economic entities in an economy. The firms are the "production units" and households are the "consumption units". These firms buy different factors of production such as machines, labour, raw materials etc., and produce and sell different types of products and services. The main aim of these firms is to maximise their profits. The households, on the other hand, try to maximise their satisfaction from their consumption of the goods produced by the firms.

Subject Matter of Economics:

In economics, a want is something that is desired. But all desires are not economic wants. The desires, which are achievable and are covered by purchasing power, are economic wants. Such wants give rise to efforts and thereby economic activity. If one wants to go to the moon, that cannot be construed as economic want as it is not covered by purchasing power.

Want is the starting point of economic activity. Wants leads to efforts. An effort leads to satisfaction.

Wants ⟶ Efforts ⟶ Satisfaction.

This is the subject matter of economics. This subject matter of economics is divided into four parts.

(i) Production

(ii) Technique and Technology

(iii) Exchange

(iv) Distribution

(v) Value

(vi) Price

(vii)Consumption

(i) Production: In economics, Production involves the creation of goods and services by using resources. It is a process to change the raw materials into final/finished goods. It is nothing but creation of utility. To produce anything so many factors are essential. All these factors are classified into four categories. They are:

(a) Land

(b) Labour

(c) Capital

(d) Organization

(ii) Technique and Technology: Technique is defined as the ratio in which the inputs are combined together to produce one unit of the product. For example, if capital (K) and labour (L) are used in the production process and if 1 unit of K is combined with 2 units of L to produce 1 unit of the product, then, K:L=1:2 will be called as the technique of production. Suppose, we know two more techniques of production eg., K:L=2:3 and K:L=3:4, then we know the technology which is nothing but the spectrum of all available techniques. Here, the knowledge of the three available techniques ie., K:L=1:2, K:L=2:3, K:L=3:4 will form the technology.

(iii) Exchange: When two individuals bring their products for trading purposes in the market, such act is called exchange when trading is complete. In olden days, goods were exchanged for goods under the "Barter system". But this system is inconvenient. Suppose, X has got cow and Y has got rice for exchange. X wants rice but Y does not want cow. So trade will not take place. Again, if one cow is exchanged for 4 Kg of rice and Y has got only 2 Kg of rice, exchange cannot take place as 2 Kg of rice cannot be exchanged for half a cow. With the introduction of money these difficulties have been smoothed out.

(iv) Distribution: Distribution means sharing of the income among the factors of production. The total income which is generated by selling of these goods and services in the market must be distributed among the factors of production in the form of rent, wages, interest and profits.

There are two types of distributions

1. Micro distribution

2. Macro distribution

(v) Value: In economics, value is of two types - use value and exchange value. Use value is the capacity of want satisfying power of any commodity - or in other words, it is the utility of the commodity. The use value of water is its ability to quench thirst.

Exchange value of commodity is its ability to be exchanged for other commocities. If 1 Kg of rice is exchanged for 2 Kg of wheat, the exchange value of rice is 2 Kg of wheat. If 1 Kg of rice is exchanged for 1/2 Kg of apple, then the exchange value of rice will be 1/2 Kg of apple and so on.

(vi) Price: Price of a commodity is the amount of money which is exchanged for one unit of the commodity. It is the exchange value of the commodity in terms of money. the exchange value of the commoidty in terms of another commodity may or may not change even if the price of the commodity changes. For instance, if both prices get doubled, the exchange value between the two commodities will remain unchanged. If the price of the other commodity does not change by the same proportion, the exchange value will, of course, change.

1. Micro Distribution

Micro distribution is nothing but pricing of factors of production. It means it explains how the price (rent) per unit of land is determined. In the same way how the price per unit of labour (wages) and capital (rate of interest), etc. is determined are discussed in this head.

Ricardian theory of rent, modern theory of rent, different wage theories, interest theories, profit theories, etc are discussed.

2. **Macro Distribution**

   Macro distribution means sharing of the total national income among the total factors of production. It means we will come to know whether the income is distributed properly or not properly among the people in the society.

   Modern economists extended the subject matter of economics. They added some other concepts to the different dimensions of economics. They are:

   (a) Employment (b) Income (c) Planning and Economic development (d) International trade

(vii)Consumption: It is an act to use the goods or service to satisfy the wants. In Economics, Consumption is typically defined as final purchase by an individual that are not investments of some sort. In other words, when you buy food, clothes, airplane tickets, a car, etc., that's consumption.

Through consumption the consumer destroys the utility of the commodity. This utility was created by the producer through production.

If someone buys a house to live in, that should be defined as consumption. If they buy a house to rent out it to someone else, that should be defined as an investment. Similarly, if they buy a car to drive, that's consumption. If you buy a car to use as a taxi for a business, that could be construed as an investment. In short the reason for the purchase determines whether something is viewed as an investment or as consumption.

1.1.1 Definitions of Economics:

The definitions of economics can be classified into four categories.

(a) Wealth definition

(b) Welfare definition

(c) Scarcity definition

(d) Growth definition

(a) Wealth definitions:

Almost all the classical economists followed wealth definitions. It is mostly associated with J.B. Say and Adam Smith. Adam Smith was called "Father of Economics". The name of the book written by Adam Smith is "An Enquiry into the Nature and Causes of Wealth of Nations" (1776). Adam Smith delinked the economics from political economy and he explained it in a scientific manner.

Definitions:

According to J. B. Say, "Economics is the study of science of wealth.

According to Adam Smith, "Economics is the science which deals with the wealth".

According to the above definitions:-

- Economics explains how the wealth is produced, consumed, exchanged and distributed.
- According to Adam Smith man is an economic man.
- Economics is a science of study of wealth only.
- This definition deals with the causes behind the creation of wealth.
- It only considers material wealth.

Criticism:

This definition was criticized by so many philosophers. They are Carlyle, Ruskin, Walras, and Dickens and others.

According to critics, economics is a decimal science, Gospel of Mammon, bread and butter science, incompleted science etc.

Wealth is of no use unless it satisfies human wants.

This definition is not of much importance to man and his welfare.

(b) Welfare definition:

This definition was given by Alfred Marshall. He was the follower of Adam Smith. He wrote a famous book "Principles of Economics" (or) "Principles of Political Economy" in 1870.

Definition:

"Economics is the study of mankind in ordinary business of life. It examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of well being".

According to Alfred Marshall's definition, economics is one side study of wealth, on the other and more important side, a part of the study of man (or) welfare of the man.

Main Points:

1. According to this definition, economics is a social science.
2. According to the definition, goods are classified into two types (or) categories:
   - Material goods
   - Immaterial goods
3. According to Alfred Marshall, economics is a normal science.
4. The top priority is given to man (or) welfare of man, secondary priority is given to wealth.
5. Marshall enhanced the status of man from economic man to social man. Economics related only some material goods which promote the human welfare.

Criticism:

This definition was criticized by Lionel Robbins on the following grounds:

1. According to Robbins, welfare definition is an incomplete definition.
2. According to Robbins, economics must be neutral between ends.
3. Marshall neglected some materials goods which do not promote human welfare, but these goods are also produced; exchanged & consumed. So, they also come under the subject matter of economics.

Example: Cigarette and alcoholic products.

(c) Scarcity Definition/Robbins definitions:

This definition was given by Lionel Robbins. He wrote a famous book "An Essay on the Nature and Significance of Economic Science" (1932).

Definitions:

"Economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses". **- Robbins**

Main Points:

In the above definition:

1. Wants are unlimited
2. Limited resources
3. Alternative uses of limited resources
4. Problem of choice

Merits:

1. According to this definition economics is an analytical science.
2. Economics turns into universal science.
3. According to Robbins, it is a positive science.
4. Neutral between ends.

Criticism:

These definitions was also criticized by so many economists on the following terms:

1. It is not a universal science.
2. Not applicable to developed countries.
3. Not applicable to communist (or) dictatorship countries.
4. It is not applicable to developing countries like India.
5. It is an old wine in a new bottle.
6. It also neglected the dynamic concepts.

(d) Growth Definition

This Definition was given by J.M. Keynes and P.A. Samuelson in the book written by Samuelson "Economics - An Introductory Analysis", (1948). In this book, he gave a new definition to economics.

Definitions

"Economic is the study of how men and society choose with 'or' without use of money to employ the scarce productive resources that would have alternative uses to produce various commodities over time for distributing them for consumption now or in future among the various persons and groups in the society. It analyses the costs and benefits of improving pattern or resource [use allocation]. **- P.A. Samuelson**

Main points:

1. Like the scarcity definition, it also accepts the unlimited wants and limited resource which have alternative uses.
2. According to Samuelson, the problem of scarcity of resources not only confined to present but also to the future. It means he introduced the concept of time element.

3. He also adopted a dynamic approach to the study of economics considering economic growth as an integral part of economics.

4. This definition includes Marshall's welfare definition and Robbin's scarcity definition.

Scope of Economics

Traditional Approach	• Economics is a social science. • It studies man's behaviour as a rational social being. • It is considered as a science of wealth in relation to human welfare. • Earning and spending of income was considered to be end of all economic activities. • Wealth was considered as a means to an end – the end being human welfare.
Modern Approach	• An individual, either as a consumer or as a producer, can optimize his goal is an economic decision. • The scope of Economics lies in analyzing economic problems and suggesting policy measures. • Social problems can thus be explained by abstract theoretical tools or by empirical methods. • In classical discussion, Economics is a positive science. • It seeks to explain what the problem is and how it tends to be solved. • In modern time it is both a positive and a normative science. • Economists of today deal economic issues not merely as they are but also as they should be. • Welfare economics and growth economics are more normative than positive.

1.1.2 Micro and Macro Economics

The term 'Micro' and 'Macro' were introduced by Ragnar Frisch in Economics. He is the Prof. of Oslo University in Britain. According to him, economics is studied in two ways i.e., Micro level and Macro level.

Meaning of Micro Economics:

The word Micro is derived from the Greek work 'Mikros', means 'very small or millionth part'. It studies about the behavior of individual units. Individual units are a consumer, a producer, a firm or industry. Marshall developed the Micro economics very well. According to Marshall, the Micro economics divide the economy into small units or small parts and each part is studied. It explains how a consumer gets maximum satisfaction, how the producer gets maximum output and how the firm gets maximum profit.

Definition:

Micro economics is the study of "particular firm particular household, individual prices, wages, incomes, individual Industries, particular commodities". **- K. E. Boulding**

Scope of Micro Economics:

The Micro economics explains how the price of a good is determined and how the price per unit of factors of production is determined and it also deals with theories of economic welfare. So Micro economics is called "Price theory".

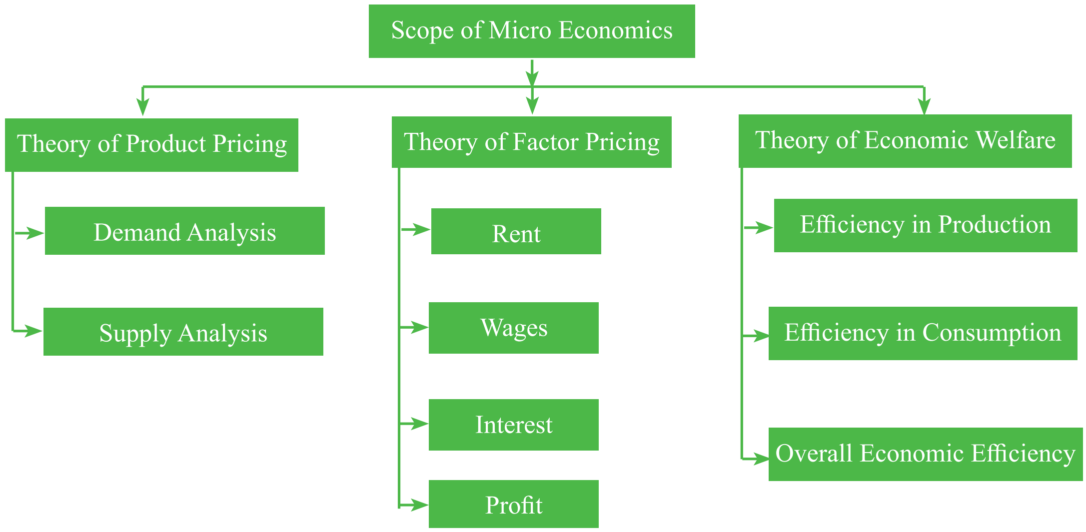


Figure: 1.1 Scope of Micro Economics

Uses or Significance of Micro Economics:

1. Understanding the operations of economy
2. Economic welfare of people
3. Managerial economics

Macro Economics:

The word "Macro" is derived from Greek word "Makros", means "large or very big". The Macro economics studies the economy as a single unit. It does not deal with individual units. It deals with the aggregates 'or' totals and averages.

For example: National Income, full employment, total output, total investment, total consumption etc.

Definition:

According to Gardner Ackley, "Macro economics is concerned with such variables as an aggregate volume of output of a economy with the extend to this resources are employed with the size of the national Income and with the general price level".

Scope of Macro Economics:

Macro economics studies about the National Income i.e. calculation of the national income, trends in the national income etc., It also deals with total employment (full employment), total output etc., It also studies about trade cycles, Inflation etc., It also deals with theories of economic growth and macro theory of distribution. It is also called Income and Employment theory.

Both Micro and Macro Economics are interdependent. From 1930 onwards there is an importance to the Macro economics.

Scope of Macro economics can be explained by the following chart.

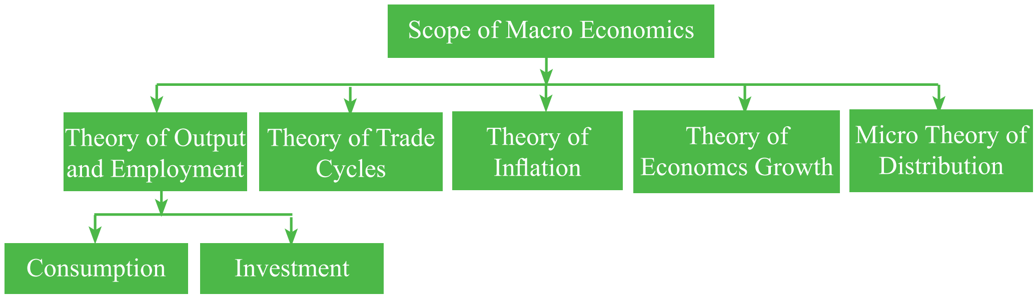


Figure: 1.2 Scope of Macro Economics

The Macro economics analyses some problems of the economy:

1. Level of output and employment.
2. Fluctuation in level of output, employment and National Income.
3. Changes in the general price level.
4. Economic growth and economic development.
5. Theories of distribution.

Significance of Macro economics:

1. Understanding the working of an economy
2. Formulating policies
3. Preparations of the economics plans
4. Taking the remedial measures of trade cycles & Inflation

Is Economics - An Art or Science

Meaning of Science:

The term science implies:-

1. A systematic body of knowledge which traces the relationship between cause and effect.
2. Observation of certain facts, systematic collection and classification and analysis of facts
3. Making generalization on the basis of relevant facts and formulating laws or theories there by.
4. Subjecting in the theories to the test of real world observations.
5. Like the subjects, physics, chemistry botany and economics also satisfies the above four characteristics. Hence, Economics is regard as science.

Economics as an Art:

Keynes defines Art as ‘a system of rules for the attainment of a given end”. The object of Art is to formulate rules to be used for the formulation of policies.

Difference between Science and Art:

1. Science is theoretical but art is practical.
2. Science teaches us "to know", an Art teaches us "to do".
3. Economics is science in its methodology and Art in its application.
4. Hence, economics is considered as both Science as well as Art.

Is Economics Positive Science 'or' Normative Science?

Economics as a positive science:

1. The positive science explains "what it is" but not "what ought to be"
2. It explains about the things as they are
3. It does not deal with value judgments.
4. According to Lionel Robbins Economics is a Positive Science.

Economics as a Normative Science:

1. A normative science explains what ought to be and what not ought to be.
2. It does relate to value judgments
3. It deals with good & bad (or) right and wrong.
4. According to Alfred Marshall Economics is a Normative Science.
5. To conclude Economics is both positive & Normative Science

Deductive Method and Inductive Method

Deductive method is a static analysis and Inductive method is dynamic.

Deductive Method:

1. It is also called prior method, abstract method and analytical method.
2. In this method the laws or theories are prepared on the basis of fundamental assumptions.
3. In this method the logic proceeds from general to particulars.

   For example: law of D.M.U, law of equi-marginal utility, law of consumer surplus etc.
4. Classical economists followed deductive method.

Inductive Method:

1. This method is also known as historical method 'or' statistical method.
2. In this method, the laws 'or' theories are prepared on the basis of facts 'or' statistical data.
3. In this method, the logic proceeds from particular to general.

   For example: law of variable proportions, law of returns to scale, population theories etc.

4. Modern economist followed Inductive method.

Central Problems of All Economies

Due to the scarcity of resources, every economy faces problems. The central problems of all economics are explained as follows:

What to produce?

An economy should produce something on the basis of the requirements of the society. Further, if the present is given importance the resources are diverted for the production of consumer goods. If future is given importance the resources are diverted for the production of capital goods.

How to produce?

This problem is arising because of unavailability of some resources. A country may produce by labour intensive technique 'or' capital Intensive technique, depending upon its man power and stock of capital.

For whom to produce?

Government policy determines what are the commodities to be produced and for whom. One can make a conjecture from the pattern of production of the country. If the government decides to produce more ordinary buses than luxury cars then one can understand that the country is producing for the poor and not for the rich.

Utility, Wealth and Production

1.2

1.2.1: Utility

Utility is a measure by which a consumers scale of preference on a good or service is quantified. Production, on the other hand is the quantity obtained from the use of the efficient combinations of the different factors/inputs. In the later part we will come to these two concepts in detailed. Now we discuss on Wealth

1.2.2: Wealth

The stock of goods under the ownership of a person 'or' a nation is called wealth.

(a) Personal wealth:

The stock of goods under the ownership of a person is called personal wealth.

For example: Houses, buildings, furniture, land, money in cash, company shares, stocks of other commodities etc., health, goodwill etc. can also be considered to be the parts of Individual wealth. But in economics, only transferable goods are considered as wealth.

(b) National Wealth:

The stock of goods under the ownership of a nation is called national wealth. It includes the wealth (common property) of all the citizens in the country. For example: Natural resources, roads, parks, bridges, hospitals, public education institutions etc., If the citizen of the country holds a government bond it is personal wealth. But from the Government point of view, it is a liability. So, it should not be considered as the part of wealth of nation.

Wealth and Welfare:

Welfare means well-being 'or' happiness. Generally, if the level of wealth increases, welfare also increases but:

1. It is doubtful whether the welfare increases if a nation goes on creating wealth without paying any consideration to the health and mental peace of citizens, whether welfare increases.
2. It is doubtful if the wealth is not distributed properly.

Wealth and Income:

A person ('or' a Nation) consumes a part of income and saves the rest. These savings are accumulated in the form of wealth. Wealth is a stock owned at a point of time. Income is a flow, over a period of time.

1.2.3: Production

It refers to creation of goods for the purpose of selling them into the market. In one word, production means

'Creation of utility". When a child make a doll for playing for her enjoyment, it is not called production but the doll maker who sells these dolls in the market is engaged in production.

Factors of production:

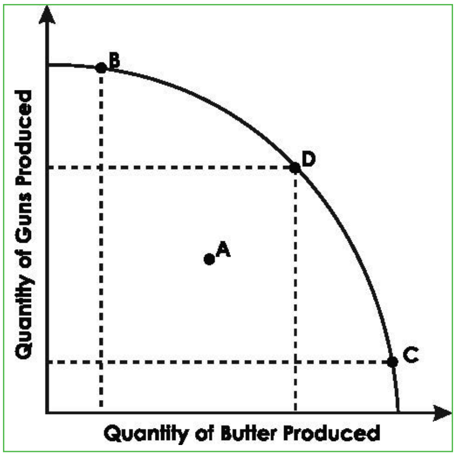
The goods and services with the help of which the process of production is carried out are called factors of production. The total factor of production are the following:

1. Land
2. Labour
3. Capital
4. Organization

The factors of production are also called Inputs. The goods and services produced with the help of Inputs are called output.

Production Possibility Curve (PPC):

The PPC is also called Production Possibility Frontier, Production Possibility Boundary and Production Transformation Curve. The PPC curve shows the various combinations of two commodities that can be produced by an economy with the given resources and given technology.



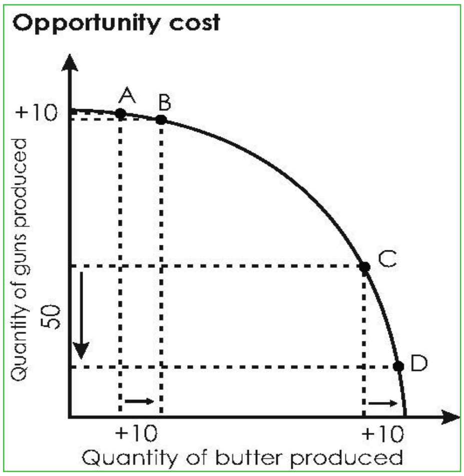


Figure: 1.3 Production Possibility Curve

Main points:

1. The PPC curve always slopes downwards form left to right. Because when the production of one commodity is increased the production of another commodity will be foregone. This is due to resource constraint of the economy.
2. The slope of the PPC at any given point is called Marginal rate of transformation (MRT). The slope defines the rate at which production of one good can be redirected into production of other. It is also called opportunity cost.
3. It is concave to the origin because Marginal rate of Transformation (MRT) goes on increasing.

   Suppose, we are on the point D of the left hand diagram of fig.1.2. If we now try to move to the right, we are in fact throwing away guns and taking butter instead. There are some specialised input which are meant for gun factory will be useless in the butter factory. So, gradually more and more inputs will become unemployed. Hence, the sacrifice of the same number of guns will yield less and less amount of butter as we move to the right and this will result in a concave curve. In other words, the Marginal Rate of Transformation will be falling.

Note:

- If the PPC curve is straight line, the opportunity cost is constant.
- All the combinations which lie on the PPC curve are possible combinations.
- The points beyond the PPC curve are impossible combinations.
- Shift of the PPC curve is nothing but economic growth.
- Any point which lies below the PPC curve is possible combination. But if the economy is working below the PPC curve that indicates the unused resources 'or' unemployment.

PPC curve solve the economic problems

If we can choose a point on the PPC curve, then we will be able to solve the first economic problems i.e., what to produce. Since the chosen point is on the PPC curve, we are utilising all the resources fully and efficiently. Now the question is how to land up on a point on the PPC curve? Adam Smith identified an "invisible" hand which will guide the economy to reach that coveted point. The "invisible" hand is nothing but the "price system". If too little has been produced, demand for that good would exceed supply. This would push up the price of that good. This will induce producer to produce more of that good than the others. Once we have solved the first question of what to produce, next question comes up: how to produce? A labour intensive technique would employ relatively more labour and little capital. A capital intensive technique would do the opposite. Which technique is to be chosen depends on the prices of the factors of production. If labour is cheap and capital is expensive, a labour intensive technique would be chosen. The third question is : for whom to produce? A commodity is consumed only by people who have the purchasing power. When the price system decides the price of labour ie., the wage rate and the amount of labour to be employed, it also determines the income of the workers ie., their purchasing power. Thus, when the prices of every commodity and every factor of production are determined, we know which commodity will go to which consumer and in what quantity.

(i) Money:

Anything which is widely accepted in exchange of goods or in settling debts is regarded as money. Barter system existed before the introduction of money.

Under barter system, goods are exchanged for goods. For example, 1 kg of rice is exchanged for 2 kg of wheat. But if 2 goats are exchanged for 1 cow, the problem of indivisibility crops up. 1 goat cannot be exchanged for ½ a cow. So, barter system was replaced by the monetary system.

When some commodities are used as a medium of exchange by customs, it is called customary money. For example: The use of cowries in ancient India as a medium of exchange.

Constituents of Money Supply:

1. Rupee notes and coins
2. Credit cards
3. Traveler's cheques

(ii) Income:

The net inflow of money (purchasing power) of a person over a certain period of time is called income For example: Daily income, weekly income, monthly income and yearly income.

(iii) Saving:

Saving is defined as income minus consumption. Whatever is left in the hands of an individual after meeting the consumption expenditure is called saving. Saving is generated out of current income and also out of past income.

(iv) Market:

In ordinary language, the term market refers to a place where the goods are bought and sold. But in economics it refers to a system by which the buyers and sellers establish contact with each other directly 'or' indirectly with a view to purchasing and selling the commodity.

Function of the Market:

a. To determine the price of the goods.

b. To determine the quantity of goods [supply]

Market Mechanism:

Market Mechanism means the totality of all markets i.e. the markets for all goods & services in the economy. The market mechanism determines the prices and quantities brought and sold of all the goods and services.

(v) Capital Stock and Investment:

Investment is the increment in capital stock. Suppose, we have a reservoir filled with water and there is a tap over the reservoir. If the tap is turned on, water will flow in the reservoir and the water level in the reservoir will increase. If we are permitted to draw analogy, then, water in the reservoir can be compared to the capital stock and the water-flow from the tap can be compared with the investment.

Capital stock indicates the productive capacity of the economy. Suppose, with 100 machines the economy can produce at the maximum 1,00,000 units of output. Here, 100 machines represent the capital stock and 1,00,000 units of output represent productive capacity. If the economy decides to increase the level of output, it has to produce new machines. Producing new machines is called capital formation or investment. If through out the year 50 machines are produced, then these 50 machines will be the investment for the economy. The economy can start production with 150 (100 + 50) machines as the new capital stock in the next year.

Types of Investment:

(a) Real Investment:

An increase in the real capital stock is called real investment. For example machines, raw material, buildings and other types of capital goods.

(b) Portfolio Investment:

The purchasing of new shares of a company is called portfolio investment.

Note: Purchasing of an existing share from another share holder is not an investment. Because it cannot increase the capital stock of the company.

It is the savings that are invested:

In the product market in the macroeconomic frame work, equilibrium will be established when the following equation holds.

$$Y = C + I$$

Where, Y is the National Income (or, output), C is Consumption demand and I is Investment demand.

The right hand side of the equation is aggregate demand and the left hand side of the equation is aggregate supply. In equilibrium, aggregate demand is exactly equal to aggregate supply. Aggregate supply or, National Income can be sub-divided into two parts, namely, consumption and savings (C+ S). Therefore, equilibrium equation will now be as follows:

$$C + S = C + I$$

$$\text{Or,} \quad S = I$$

So, in equilibrium, savings is equal to investment. But there is no guarantee that these two should always be equal. This is because savings are made by the households while investments are undertaken by the businessmen. Their motives are completely different.

⊙ Note: If there is foreign investment then $S \neq I$.

Gross Investment and Net Investment:
The Aggregate Investment made by an economy during a year is called gross investment. The gross investment includes:

(a) Inventory Investment:

Investment in raw materials, semi finished goods and finished goods are called inventory investment.

(b) Fixed Investment:

Investment made in fixed assets like machines, building, factories shares etc. is called fixed investment.

Net Investment:

By deducting the depreciation cost of capital from gross investment, the net investment can be obtained.

Net Investment = Gross Investment – Depreciation

Theory of Demand, Supply and Equilibrium 1.3

1.3.1 Demand

Meaning of Demand

Demand means 'desire in common parlance'. But in economics demand means desire backed by the purchasing power and willingness to pay the price. Demand is basically a purchase of any good or service which involves the expositions of the desire by the demander, the customer, and the ability of the demander. Ability or purchasing power is measured usually by the level of income and wealth of the customer. For example, a student demands for a book on Managerial Economics by a particular author. Though he has the desire to take and read the book but he may not purchase the book because he may not have that much of money. Hence to complete demand for a good or service there should be the combinations of desire and purchasing power. In the following discussions we will be covering details on the topic of theory of demand.

Determinants of demand:

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

1. **Price of the goods:**

   The demand for any commodity firstly depends upon its own price. When the price rises demand decreases, and when the prices falls demand increases.

2. **Prices of the substitute goods:**

   The demand for any commodity not only depends upon its own 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.

   If the price of coffee falls, the demand for coffee will rise following the law of demand. Since coffee is the substitute for tea, people will reduce the consumption of tea and increase the consumption of coffee, as coffee is now relatively cheaper than tea. So, when the price of coffee falls, the demand for tea will also fall. The essence of this example is that demand for a commodity, Dn and the price of its substitute, Ps are directly or positively related.

3. **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 the demand for petrol depends upon price of the car.

   If the price of petrol rises, the demand for petrol will fall, following the law of demand. Since petrol is complementary to the car, people will reduce the demand for car along with petrol. So, when the price of petrol rises, the demand for car will fall. This analysis indicates that the demand for a commodity, Dn and the price of its complement, Pc are inversely related.

4. **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. This happens when the good is normal. But the reverse relation will work when the good will be inferior.

5. **Tastes and preferences of the consumer:**

   The tastes and preferences of the consumer can also determine the demand for a commodity. When the tastes are changed, the demand for goods are also changed.

6. **Population:**

   When the population size increases, the demand for goods also increases. When the population decreases demand also decreases.

7. **Climate:**

   The climatic conditions also can influence the demand. In hot climatic conditions, cold drinks are demanded. In rainy season, the demand of umbrellas are increased.

Law of Demand

The law of demand is a general statement stating that price and quantity demanded of a commodity are inversely related.

Demand Function:

Demand function explains the functional relationship between price and quantity demanded. According to the law of demand, when all other things remain constant, if the price of the good rises then its demand is decreased. If the price falls, demand will be increased. It means there is an inverse relationship between price and change in demand/ change in price is negative in sign.

$$Dx = f\,[Px]$$

The demand function explains the functional relationship between demand for a commodity and determinants of the demands. This can be explained by the following equation:

$Dn = f\,[\,Pn, Ps, Pc, Y, T\,]$

Where, Dn = Demand for commodity 'n'

f = functional relationship

Pn = Price of commodity 'n'

Ps = Price of the substitute

Pc = Price of the complement

Y = Income of the consumer

T = Taste and preference of the consumer

Demand Schedule:

It shows the various quantities of the goods that are demanded at various levels of prices. There are two types of demand schedules:

1. Individual Demand Schedule

2. Market Demand Schedule.

1. Individual Demand Schedule:

It shows the various quantities of a particular good that are demanded by an individual at various levels of prices in the market.

Price	Demand
5	10
4	20
3	30
2	40
1	50

Individual Demand Curve:

From the demand schedule we can derive demand curve

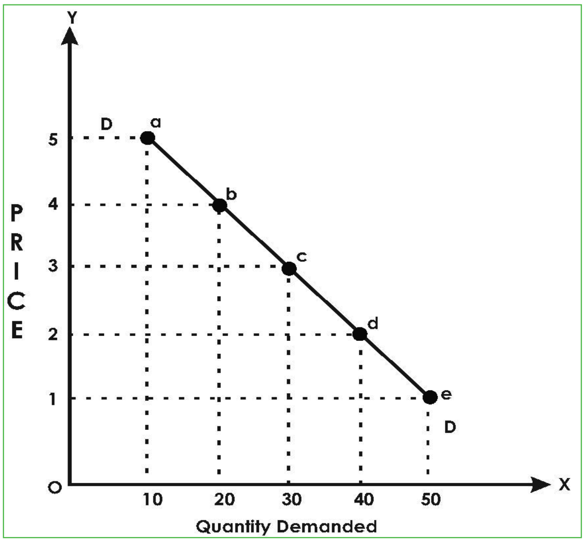


Figure: 1.4 Individual Demand Curve

2. Market Demand Schedule:

It shows the various quantities of the goods that are demanded by all the consumers (A, B, C .... say) in the market at various levels of prices in the market. When the individual demands are added, market demand then be obtained.

Price of Good 'x'	Demand			
	A	B	C	Demand (A+B+C)
10	100	150	50	300
8	125	200	60	385
6	175	250	80	505
4	250	300	110	660
2	350	400	150	900

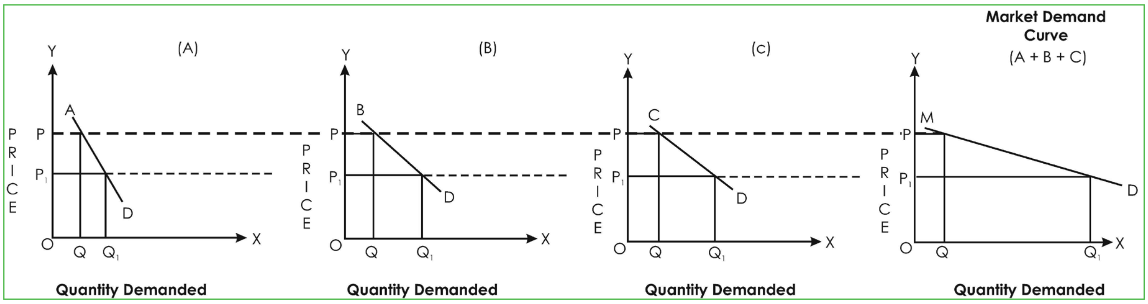


Figure: 1.5 Market Demand Curve

The individual demand curve or market demand curve slopes downwards from left to right because there is an inverse relationship between price and demand.

Causes for falling nature of Demand Curve i.e. downward sloping demand curve:

There are many reasons for the falling nature of demand curve. Some of the reasons are explained as follows:

1. **Law of diminishing marginal utility:**

   According to law of diminishing marginal utility when the quantity of goods is more the marginal utility of the commodity will be less. So, the consumer demands more goods when the price is less. That is why, the demand curve slopes downwards from left to right.

2. **Substitution effect:**

   In the case of substitutes, if the price of commodity 'x' rises relatively to the other good 'y' the consumer will buy less of commodity 'x' and buy more of the good 'y' which has become relatively cheaper. This is called substitution effect. So the demand curve slopes downward.

3. **Income effect:**

   The income effect tells that the real income of the consumer rises due to the fall in the price level. So they purchase more and more goods when the price falls. This is said to be the income effect.

4. **New buyers:**

   When the price of a commodity decreases, the new consumers are attracted to that commodity because when the price level falls it becomes cheaper good than before. So, the demand will rise when the price falls.

5. **Old buyers:**

   When the price of anything decreases the old buyers purchase more goods than before. So the demand will be increased. That is why, the demand curve slopes downward from left to right.

Exceptions to the Law of Demand:

The law of demand is a general statement stating that price and quantity demanded of a commodity are inversely related. But in certain situations, more will be demanded at a higher price and less will be demanded at a lower price. In such cases, the demand curve slopes upward from left to right which is called an exceptional demand curve as shown in the following diagram.

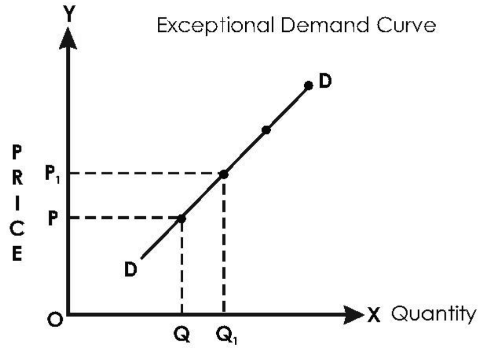


Figure: 1.6 Quantity Demanded

When price increases from OP to OP_1, quantity demanded also increases from OQ to OQ1. This is contrary to the Law of Demand. The following are the exceptions to the Law of Demand.

1. **Giffen Paradox (Necessary goods):**

   In the case of necessary goods, the law of demand cannot be operated. This is observed by British Economist, Sir Robert Giffen. He observed in London the low paid workers purchases more of bread when its price rises. That's why, this situation is known as Giffen Paradox.

2. **Speculation:**

   Some times the price of a commodity might be increasing and it is expected to increase further. The consumers will buy more of the commodity at the higher price than they did at the lower price. It is contrary to law of demand.

3. **Conspicuous:**

   These are certain goods which are purchased to project the status and prestige of the consumer e.g., expensive cars, diamond jewellery, etc. Such goods will be purchased more at a higher price and less at a lower price.

4. **Shares or Speculative market:**

   It is found that people buy shares of a company whose price is rising on the anticipation that the price will rise further. On the other hand, they buy less shares in case the prices are falling as they expect a further fall in price of such shares. Here, the law of demand fails to apply.

5. **Bandwagon effect:**

   Here the consumer demand of a commodity is affected by the taste and preference of the social class to which he belongs to. If playing golf is fashionable among corporate executive, then the price of golf accessories rises, the business man may increase the demand for such goods to project his position in the society.

6. **Veblen Effect:**

   Sometimes, consumers develop a false idea that high priced goods will have a better quality instead of a low priced good. If the price of such a good falls, they feel that its quality also deteriorates and they do not buy, which is contrary to the law of demand. It is also known as Veblen Effect.

Types of Demand:

There are three types of demands. They are:

1. Price demand
2. Income demand
3. Cross demand

1. **Price Demand:**

   Price demand explains the relationship between price of a commodity and demand for that commodity. There is an inverse relationship between price and demand. So, the price demand curve slopes downwards from left to right.

$$Dx = f [Px]$$

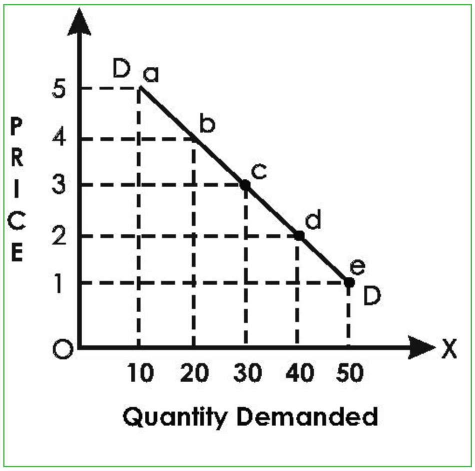


Fig: 1.7 Demand Curve – Price-Quantity Relationship

2. **Income Demand:**

   Income demand explains the functional relationship between income of consumer and demand for goods. Generally, if the level of income rises, the consumer purchases more goods. If the level of income decreases he purchases less quantity of goods. It means there is a direct proportional relationship between income of consumer and demand of goods. So, normally the income demand curve slopes upwards form left to right.

$$Dx = f [y]$$

The income demand curve is of two types:

In case of superior goods ‘or’ normal goods the income demand curve [I.D.] slopes upwards from left to right. Superior goods mean ‘best quality goods’.

In the case of Inferior goods the I.D. slopes downwards form left to right inferior goods means “less quality goods”.

Inferior goods:

Inferior goods **Normal goods/ superior goods**

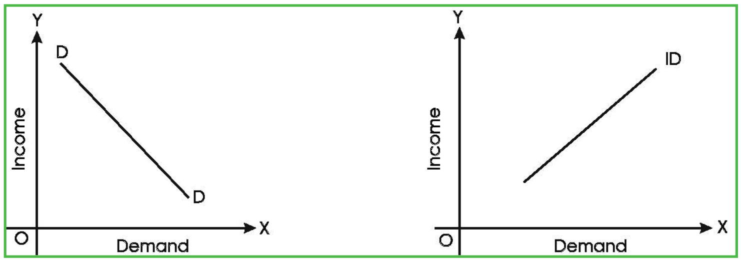


Figure: 1.8 Demand Curve – Normal Goods and Inferior Goods

3. **Cross Demand:**

It shows the relationship between price of one commodity and demand for another commodity. It means the demand for one commodity not only depends upon its price but also prices of its substitute goods and complementary goods.

$$D_x = f\,[P_y]$$

The cross demand curve is in two types:

It is upwards from left to right in the case of substitute goods and its slope downwards from left to right in the case of complementary goods.

Substitute goods:

If one good is used in the place of other good to satisfy the same want they are called substitute goods.

Example: Tea & coffee, pen & pencil etc.

In the case of substitute goods, there is a direct proportional relationship between price of one commodity and demand for another commodity. So, the crossed demand curves [CD] in this case is upward from left to right.

Complementary goods:

If two 'or' more goods are used jointly to satisfy the single want they are called complementary goods.

Example: Milk, sugar, tea powder etc., are complementary for tea, cement, bricks, iron etc., are complementary for construction work. In this case of complementary, there is an inverse relationship between price of one commodity and demand for another commodity. So, C.D In this case slopes downwards from left to right.

Complementary **Substitutes**

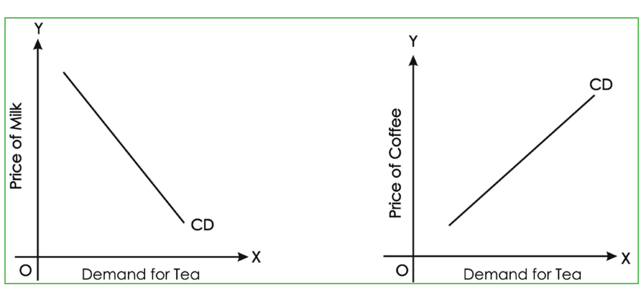


Figure: 1.9 Complementary and Substitutes Goods

Change in Demand and Change in Quantity Demanded:

The change in the determinants of a demand leads to the change in demand. These changes in demand are of two types. They are:

1. Extension and contraction of demand
2. Increase and decrease of demand

1. Extension and Contraction of Demand:

When all the other things remain constant, a change in the price leads to the change in demand. These changes in demand are called extension and contraction of demand. When the price is decreased the demand is extended when the price is increased the demand is contracted. To explain the extension and contraction of demand a single demand curve is enough.

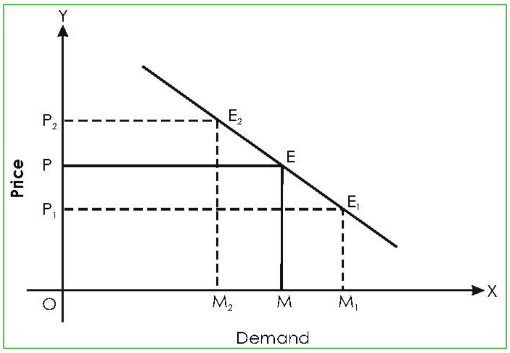


Figure: 1.10 Change in Quantity Demanded

2. Increase and decrease of demand

With the price remaining constant, if there is a change in the other determinants that leads to a change in demand then these changes in demand are called "Increase and decrease of demand". To explain the increase and decrease of demand, single demand curve is not enough. It means new demand curves are formed.

1. When the demand is increased, the new demand curve is formed towards right to old demand curve 'or' preceding demand curve.
2. In the same way, when the demand is decreased, the new demand curve is formed towards left to old demand curve 'or' preceding demand curve.

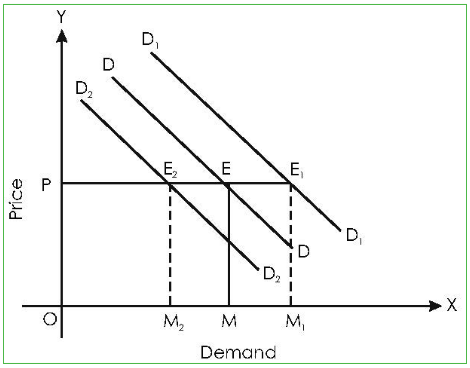


Figure: 1.11 Change in Demand

Elasticity of Demand

Meaning of Elasticity of demand

Elasticity means sensitiveness 'or' responsiveness. Elasticity of Demand means degree of response in demand. Due to different demand determining factors, the elasticity of demand explains the change in demand due to the change in the determinants of the demand.

Type of Elasticity of demand

There are three types of elasticity of demand. They are:

1. Price elasticity of demand.
2. Income elasticity of demand
3. Cross elasticity of demand.

1. Price Elasticity of Demand:

It shows the relationship between proportionate change in the demand and proportionate change in the price. It explains how much change in the price leads to how much change in the demand.

$$E_p = \frac{\text{Proportionate Change in Demand}}{\text{Proportionate Change in Price}}$$

$$E_p = \frac{\frac{dq}{q}}{\frac{dp}{p}}$$

$$E_p = \frac{dq}{dp} \times \frac{p}{q}$$

Definition:

"Elasticity of demand in a market great or small according to the demand increases much 'or' little for a given fall in the price and diminishes much 'or' little for a given rise in the price" **– Marshall**

"Elasticity of demand is a degree of responsiveness of demand as a result of change in price.

– Mrs. John Robinson

Values of price elasticity of demand:

There are five values of price elasticity of demand

1. Perfectly elastic demand ($E_p = \infty$)
2. Perfectly Inelastic demand ($E_p = 0$)
3. Relatively elastic demand ($E_p > 1$)
4. Relatively Inelastic demand ($E_p < 1$)
5. Unitary elastic demand ($E_p = 1$)

1. Perfectly elastic demand ($E_p = \infty$):

With the price remaining constant, if there is a change in demand it is said to be perfectly elastic demand. It means that the demand may increase 'or' decrease without change in the price. Here the value of E_p is infinity.

The demand curve in this case parallel to the OX axis

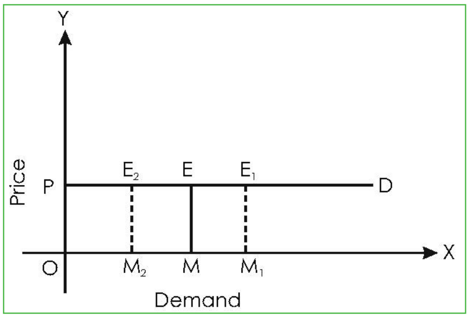


Figure: 1.12

2. Perfectly Inelastic demand ($E_P = 0$):

With the change in price, if there is no change in the demand it is said to be perfectly inelastic demand. It means that the price may increase 'or' decrease but the demand is constant. Here the value of $E_P = 0$.

The demand curve in this case is parallel to OY axis. It holds for goods like salt, life saving drug, etc.

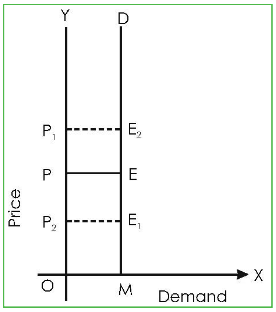


Figure: 1.13

3. Relatively Elastic Demand (Ex: luxury goods): ($E_P > 1$)

If the proportionate change in demand is more than proportionate change in the price, it is said to be relatively elastic demand. It means a little change in the price leads to more change in demand. Here the value of E_P is greater than one the demand curve in the case slopes downward from left to right.

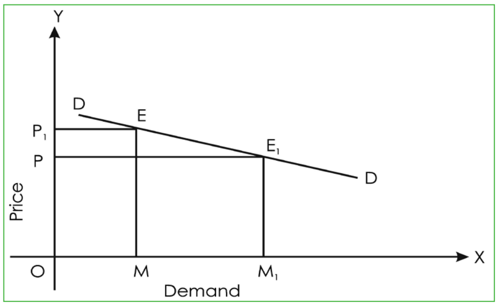


Figure: 1.14

4. Relatively Inelastic demand (ex: necessary goods) ($E_P < 1$)

If the proportionate change in demand is less than proportionate change in the price, it is said to be relatively inelastic demand. It means more change in the price leads to less change in demand. Here the value of E_P is less than one. The demand curve in this case slopes down wards from left to right. But is steeper than relatively elastic demand.

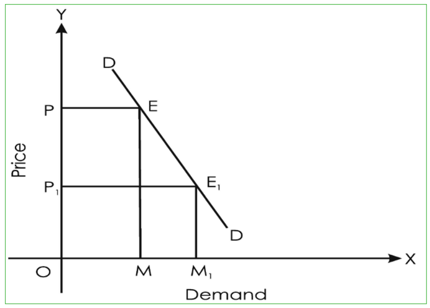


Figure: 1.15

5. **Unitary elastic demand: (E_P = 1)**

If the proportionate change in the demand is equal to the proportionate change in the price. It is said to be unitary elastic demand. It means the change in the demand and change in price are same. Here the value of E_P is 1. Generally comfort goods have unitary elastic demand. The demand curve also slopes downwards from left to right but it is rectangular hyperbola.

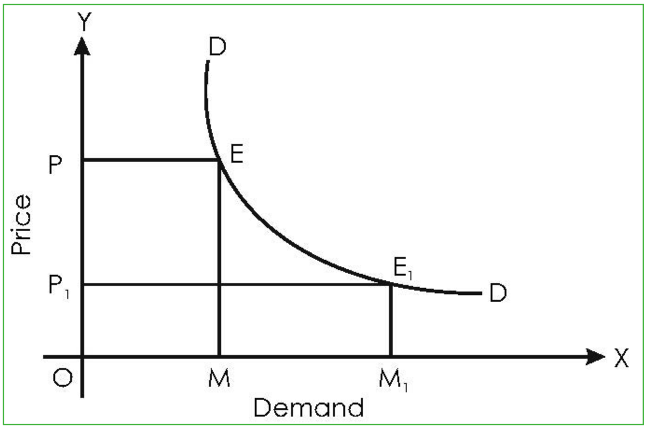


Fig: 1.16

Income elasticity of demand:

It shows the proportionate change in demand with respect to proportionate change in income. It means it explains how much change in the income leads to how much change in demand.

$$E_p = \frac{\text{Proportionate Change in Demand}}{\text{Proportionate Change in Income}}$$

$$E_y = \frac{\frac{dq}{q}}{\frac{dy}{y}}$$

$$E_y = \frac{dq}{dy} \times \frac{y}{q}$$

Values:

- Perfectly elastic Income demand ($E_Y = \infty$)
- Perfectly Inelastic Income demand ($E_Y = 0$)
- Relatively elastic Income demand ($E_Y > 1$)
- Relatively Inelastic Income demand ($E_Y < 1$)
- Unitary elastic Income demand ($E_Y = 1$)

1. **Perfectly elastic Income Demand**

   With the income remaining constant, if there is a change in the demand, it is said to be perfectly elastic income demand. It means the demand may increase 'or' decrease without change in income. Here the value of E_Y is infinity. The demand curve in this case is parallel to OX- axis.

2. **Perfectly Inelastic Income demand:**

   If there is no change in the demand it is said to be perfectly inelastic income demand. It means the income may be increase 'or' decrease but the demand is constant Here the value of E_Y is zero. The demand curve in this case is parallel to OY – axis.

3. **Relatively elastic Income Demand:**

   If the proportionate change in the demand is more than proportionate change in income, it is said to be relatively elastic income demand. It means a little change in the income leads to more change in demand. Here the value of E_Y is greater than one. The demand curve in this case slopes upwards from left to right with relatively flatter in shape.

4. **Relatively Inelastic Income Demand:**

   If the proportionate change in the demand is less than proportionate change in income, it is said to be relatively inelastic income demand. It means a more change in the income leads to less change in demand. Here the value of E_Y is less than one. The demand curve in this case slopes upwards from left to right with relatively steeper in shape.

5. **Unitary elastic income demand:**

   If the proportionate change in the demand is equal to proportionate change in Income. It is said to be unitary elastic income demand. It means the change in the income and changes in the demand are same. Here the value of E_Y is one. The demand curve in this case also upward from left to right.

Cross elasticity of demand:

It shows proportionate change in the demand for one commodity and proportionate change in the price of other commodity. It explains how much change in the price of one commodity leads to how much change in the demand for another commodity.

$$E_p = \frac{\text{Proportionate Change in Demand for goods 'x'}}{\text{Proportionate Change in Price for goods 'y'}}$$

$$E_c = \frac{\frac{dq_x}{q_x}}{\frac{dp_y}{p_y}}$$

$$E_c = \frac{dq_x}{dp_y} \times \frac{p_y}{q_x}$$

Methods of Measurement of elasticity of demand:

There are four methods to measure the elasticity of demand. They are:

1. Percentage method
2. Total outlay method
3. Point method
4. Arc method

1. Percentage Method:

In this method, to measure the elasticity of demand firstly we should find out the change in demand and change in price in percentages. Then the following formula can be used:

$$E_p = \frac{\text{Proportionate Change in Demand}}{\text{Proportionate Change in Price}}$$

2. Total outlay Method:

In this method, on the basis of relationship between price and total expenditure elasticity can be decided

- If the total expenditure increases with the falling of the price and decrease with the raising of the price, it is said to be relatively elastic demand ($E_p > 1$).
- With total expenditure remaining constant the increase 'or' decrease in price it is said to be unitary elastic ($E_p = 1$).
- If the total expenditure decreases with the falling of the price and increase with the raising of the price. It is said to be relatively in elastic demand ($E_p < 1$).

Price	Demand	Total Outlay
9	40	360
8	50	400
7	60	420
6	70	420
5	80	400
4	90	360

3. Point Method:

In this method the elasticity of demand can be measured at a particular point on the demand curve. In this method the following formula can be used:

$$E_p = \frac{\text{Lower Segment}}{\text{Upper Segment}}$$

Let us assume the total length of the demand curve is - 40cm. AB is the demand curve in the diagram. How the elasticity of demand can be measured on the demand curve is explained in the following way.

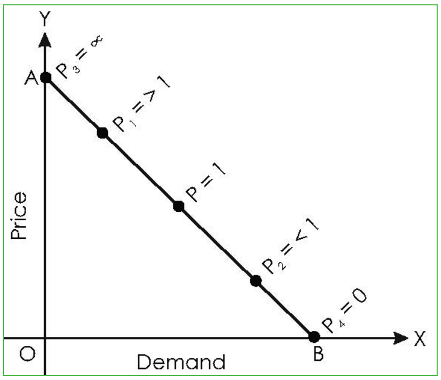


Figure: 1.17

E_p at point 'P' $= \dfrac{PB}{PA} = \dfrac{20}{20} = 1$

E_p at point 'P_1' $= \dfrac{P_1B}{P_1A} = \dfrac{30}{10} = 3$

E_p at point 'P_2' $= \dfrac{P_2B}{P_2A} = \dfrac{10}{30} = 0.33$

E_p at point 'P_3' $= \dfrac{P_3B}{P_3A} = \dfrac{40}{0} = \infty$

E_p at point 'P_4' $= \dfrac{P_4B}{P_4A} = \dfrac{0}{40} = 0$

4. Arc Method:

If there are big changes in demand and prices it is not possible to measure the elasticity of demand by the point method. So, the Arc method is introduced. In this method, the following formula can be used:

$$E_p = \frac{\text{Change in demand}}{\text{1st demand + 2nd demand}} \div \frac{\text{Change in price}}{\text{1st Price + 2nd Price}}$$

$$\frac{q_2 - q_1}{q_1 + q_2} \div \frac{p_2 - p_1}{p_1 + p_2}$$

Price	**Demand**
2 p_1	**1000 q_1**
1 p_2	**2000 q_2**

$$\frac{1000}{1000 + 2000} \div \frac{-1}{2+1}$$

$$\frac{1000}{3000} \div \frac{3}{-1} \qquad = -1$$

= unitary

Relation between AR, MR and price elasticity of demand

MR = d(TR)/dQ = d(P.Q)/dQ

Therefore, MR $= P + Q \cdot dP/dQ = P [1 + Q/P \cdot dP/dQ] = P [1 – \{ - dP/dQ \cdot Q/P \}]$

$= P [1 – \{ - 1/(dQ/dP \cdot P/Q) \}]$

$= P [1 - 1/e]$ where, $e = (-) [dQ/dP \cdot P/Q]$

Now, if $e = 1$ or, $1/e = 1$ or, $(1- 1/e) = 0$

Then, $MR = 0$

If $e > 1$ or, $1/e < 1$ or, $(1 – 1/e) > 0$

Then, $MR = P (1 – 1/e) > 0$

If $e < 1$ or, $1/e > 1$ or, $(1 – 1/e) < 0$

Then, $MR = P (1 – 1/e) < 0$

If e = infinity or, $1/e = 0$ or, $(1 – 1/e) = 1$

Then, $MR = P$

This analysis shows that a firm should produce that level of output corresponding to which price elasticity of demand is relatively elastic (i.e., $e > 1$) because the firm earns positive marginal revenue ($MR > 0$) only at that level of output. As the marginal cost (MC) of production is assumed to be positive, so the firm should produce output where $MR > 0$.

Importance of Elasticity of Demand

The concept of elasticity of demand is of great practical importance in the sphere of government finance as well as in trade and commerce.

(i) Business Decision:

If the product has more elastic demand the business man fixes less price, if the product has less elastic demand he will fix the more price.

(ii) Monopolist:

The monopolist fixes the higher price in one market in which the elasticity of demand is less. And lower price in more elastic demand market for the same thing (or) same good.

(iii) Determination of factor price:

The concept of elasticity of demand also helps in determining the price of various factors of production. Factor having inelastic demand gets higher price and factors having elastic demand gets lower price.

(iv) Route for international trade:

If demand for exports of a country is inelastic, that country will enjoy a favorable terms of trade while if the exports are more elastic than imports, then the country will lose in the terms of trade.

(v) To the government:

The concept of elasticity of demand also enable the government to decide as to what particular industries should be declared as ‘public utilities’ to be taken over and operated by the state.

Determinants of Elasticity of Demand:

(i) Nature of the commodity

(ii) Availability of substitutes

(iii) Variety of uses

(iv) Possibility of postponement of consumption

(v) Durable goods

(i) Nature of the commodity:

In the case of necessities the demand is less elastic (or) comparatively inelastic. For example rice, salt, pulses, matchbox etc.

On the other hand, the elasticity of demand for luxuries is more elastic. For example, TV, DVD players, Gold, Diamonds etc.

Comfort goods have unitary elastic demand.

(ii) Availability of substitutes:

If a commodity has substitute goods, the elasticity for that commodity is more elastic. For example, Lux soap, pears soap, ponds and Lakme creams.

(iii) Variety of uses:

If the goods have several uses, the elasticity of demand for it is more elastic. For example, milk, coal, electricity etc.

(iv) Possibility of Postponement of consumption:

There are certain goods which can be postponed for purchase. In case of these goods, the demand is elastic. But in the case of life saving medicines the demand will be inelastic because we cannot postpone the purchase of such goods.

(v) Durable goods:

In case of durable goods, the elasticity of demand will be less, but in case of perishable goods the elasticity of demand will be more.

Theory of Consumer behaviour

Consumption:

Consumption is defined as the satisfaction of human wants through the use of goods and services.

Determinants of consumption:

1. Present Income
2. Future income
3. Wealth income

The concept of consumer surplus:

This concept was introduced by Alfred Marshall. This concept is derived from the Law of Diminishing Marginal Utility. Consumer Surplus (C.S.) is the difference between willing price and actual price.

C.S. = Willing Price – Actual Price

or

C.S. = Demand Price – Market Price

Definition:

The excess of price which a consumer would be willing to pay for a thing rather than go without the thing and over what he actually does pay.

Law of Diminishing Marginal Utility:

The law of D.M.U explains the common experience of every consumer. It is based upon one of the characteristics of wants i.e. "A particular want is suitable". According to this law, when a person goes on increasing the consumption of any one commodity the additional utility derived from the additional units goes on diminishing. So, it is called law of diminishing marginal utility. The law of D.M.U was firstly profounded by H.H. Gossan in 1854. So, it is called Gossans' first law of consumption. The law of D.M.U was developed by Alfred Marshall.

Definition:

"The additional benefit which a person derives from a given increase in his stock of anything, diminishes with every increase in the stock that he already has". **- Marshall**

Concepts in this law:

1. **Total utility:**

   It is the total amount of satisfaction obtained by the consumer by the consumption of total units of a thing. The sum of marginal utilities is also called total utility.

$$TUx = f[Qx]$$

Or

$$TUx = \Sigma MUx$$

2. **Marginal Utility:**

   It is the additional utility obtained by the consumer by the consumption of additional unit of a thing 'or' one more unit of a thing. The change in the total utility is also called marginal utility.

$$MU_x = \frac{\Delta TU}{\Delta P}$$

Or

$$MUn = TU_n - TU_{n-1}$$

Table explanation:

Units	Total utility	Marginal utility
1	40	40
2	70	30
3	90	20
4	100	10
5	100	0
6	90	-10

Diagrammatic Explanation:

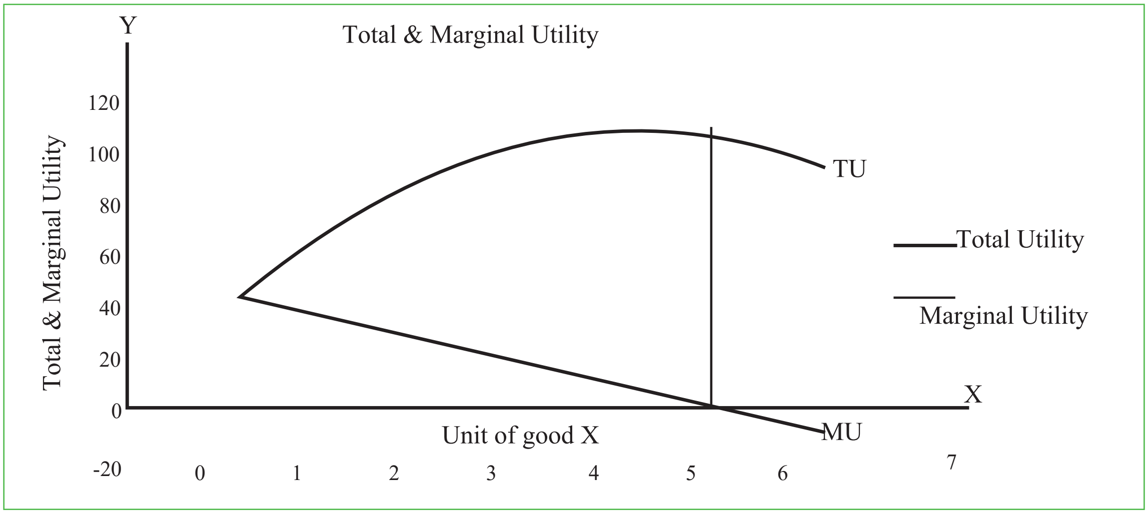


Figure: 1.18 Marginal Utility & Total Utility Curve

Main Points:

1. When total utility Increases, then the Marginal utility diminishes. So, T.U. Curve moves upward from left to right and M.U curve slope downwards from left to right.

   However, this is only true when the law of diminishing marginal utility operates. Initially, it may so happen that the marginal utility might be rising along with the total utility curve for a particular commodity.

2. When the total utility reach the maximum, then the marginal utility is zero. At this point T.U curve reached the peak stage and M.U curve intercepts 'X' axis.

3. When the total utility goes on diminishing then the M.U becomes negative. So, the T.U curves slopes downwards and M.U curve crossed the x-axis.

Assumptions:

1. The units are homogeneous.
2. The units must be of reasonable size.
3. There is a onetime gap between one unit of consumption and the next unit of consumption.
4. There is no changes in the taste and preferences of the consumer.

Exceptions to Diminishing Marginal Utility:

1. Collection of the rare goods.
2. Hobbies
3. Misers
4. Money and gold
5. Reading of books

Importance:

1. Value paradox
2. Basis for economic laws
3. Progressive Taxation
4. Re-distribution of wealth

Demand Forecasting:

The success of the business firm depends upon the successful demand foresting. Estimation of future demand for product at present is called demand forecasting.

Methods of Demand forecasting:

1. Expert opinion method
2. Survey of buyers intensions
3. Collective opinion method
4. Controlled experiments
5. Statistical method.

1.3.2 Supply

Meaning of supply:

There is a difference between stock of the goods and supply of goods. Supply means sum of the part of stock of the goods which is prepared by a seller to sell at a particular price, at a particular market in a particular period of time.

Determinants of supply:

The supply of any commodity depends upon some factors. They are called determinants of the supply. They are:

1. **Price of the goods:**

   Price of the goods is main determinant of supply. Producers supply more goods if the prices are high. They supply the fewer goods when the prices are low.

2. **Goals of the firm:**

   Firms may try to work on various goals. For e.g. Profit maximization, sales maximization, employment maximization. If the objective is to maximize profit, then higher the profit from the sale of a commodity, the higher will be the quantity supplied by the firm and vice-versa.

3. **Inputs Prices:**

   The producers supply more when the inputs prices are low, that is at lower costs of production. At higher input, price rises and the supply is reduced.

4. **Technology:**

   New Technology generally helps to save inputs and reduces costs and time to produce the output. An improved technology enhances the supply of the goods.

5. **Government Policies:**

   Government policy of taxes and subsidies on goods brings about changes in supply, higher taxes on goods discourage producers and their supply will be less. On the other hand, subsidies from government encourage producers to supply more.

6. Expectation about future prices:

If the producers expect an increase in the price of a commodity, then they will supply less at the present price and hoard the stock in order to sell it at a higher price in the near future. This will be opposite in case if they anticipate fall in future price (e.g. Fruit seller).

7. Prices of the other commodities:

Usually an increase in the prices of other commodities makes the production of that commodity whose price has not risen relatively less attractive. We thus, expect that other things remaining the same, the supply of one commodities falls the price of other goods rises.

8. Number of firms in the market:

Since the market supply is the sum of the suppliers made by individual firms, hence the supply varies with changes in the number of firms in the market. A decreases in the number of firm reduces the supply.

9. Natural factors:

Supply of goods depends on favourable weather conditions. Conditions like drought, floods, extreme weather, pests and diseases disturb crop production and raw material supply. This will affect the supply of goods.

Law of Supply:

It explains the functional relationship between supply of a good and price of the good. When all other things remaining constant, if the price rises supply also increased, if the price falls supply also falls. It means there is direct or proportional relationship between price and supply.

Supply function:

The supply function explains the relationship between the supply and the factors that determines the supply. This can be explained through an equation:

Sx = f (Px, PI, T, W, GP)

In the above equation

Sx = supply of goods 'x'

f = functional relationship

Px = Price of 'x'

PI = Price of inputs (factors)

T = Technology

W = Weather conditions

GP = Government policy

Supply Schedule:

It shows the various quantities of the goods that are supplied at various levels of prices.

Types of supply schedule:

There are two types of supply schedule. They are:

1. Individual supply schedule
2. Market Supply schedule

1. Individual supply schedule:

It shows various quantities of the goods that are supplied by an individual seller (or) producer at various levels of prices in the market.

Price of x	Supply of 'x' goods
500	0
1000	10
1500	30
2000	55
2500	90

Supply curve: From the above supply schedule the supply curve can be drawn

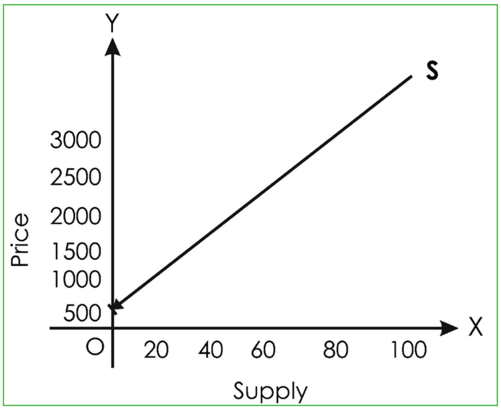


Figure: 1.19

2. Market Supply schedule:

It shows the various quantities of the goods that are supplied by various producers (or) sellers at various levels of prices in the market. When we add the supply of all sellers then total supply 'or' market supply can be obtained.

Whether the individual supply curve 'or' market supply curve slopes upward from left to right as there is a direct proportional relationship between price and supply.

Exceptions to the law of supply:

Land (or) Agriculture goods.

In the case of land (or) Agriculture goods the supply curve is parallel to OY-axis.

- **Rare goods.**

  In the case of rare goods supply cannot be changed according to the price. So in the case of rare goods the supply curve is parallel to OY-axis.

- **Supply of labour.**

  In the case of labour, the supply curve is backward bending. Because in the initial stage if the wage level is increased the supply of the labour also increased. Beyond a certain stage, if the wages are increased people will substitute leisure for paid worktime. So, the supply of labour will be decreased.

Change in Supply:

If the change in the determinants of the supply leads to the change in supply.

These changes in supply are two types. They are:

1. Extension and contraction of the supply
2. Increase and decrease of the supply.

1. Extension and contraction of the supply:

When all other things remaining constant, if there is a change in the price that leads to change in the supply then these changes in the supply are called extension and contraction of the supply. When the price is increased the supply will be extended, when the price is decreased the supply will be contracted. To explain the extension and contraction of the supply a single supply curve is enough.

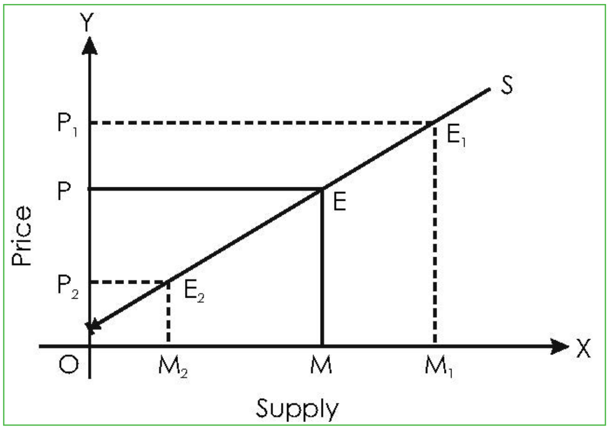


Fig: 1.20

2. Increase and decrease of supply:

When the price is constant, if there is a change in any one of the determinants that leads to change in supply, then these changes in supply are called increase and decrease of supply. To explain the increase and decrease of the supply a single supply curve is not enough. It means new supply curves are formed.

- When the supply is increased the new supply curve is formed towards right to the old supply curve.
- In the same way when the supply is decreased the new supply curve is formed towards left to the old supply curve.

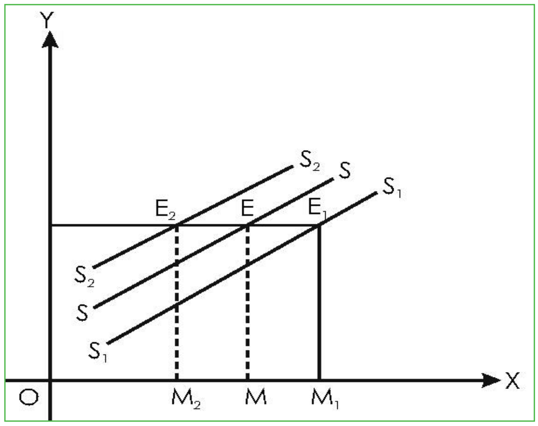


Figure: 1.21

Elasticity of supply:

It shows the ratio of the proportionate change in the supply and the proportionate change in price. It means it explains the responsiveness of supply to a change in price.

$$E_s = \frac{\text{Proportionate change in suppy}}{\text{Proportionate change in price}} = \frac{\frac{dq}{q}}{\frac{dp}{p}}$$

$$= \frac{dq}{dp} \times \frac{p}{q}$$

Values of Elasticity of Supply:

There are five values of elasticity of supply

1. Perfectly elastic Supply ($E_s = \infty$)
2. Perfectly Inelastic Supply ($E_s = 0$)
3. Relatively elastic Supply ($E_s > 1$)
4. Relatively Inelastic Supply ($E_s < 1$)
5. Unitary elastic Supply ($E_s = 1$)

1. Perfectly elastic Supply ($E_s = \infty$):

When the price is constant if there is a change in supply, it is said to be perfectly elastic supply. It means the supply may increase 'or' decrease without change in price. Here, the value of E_s is infinity. The supply curve in this case is parallel to OX axis.

2. Perfectly Inelastic Supply ($E_s = 0$):

When the price is changed, if there is no change in the supply, it is said to be perfectly inelastic supply. It means the price may increase 'or' decrease but the supply is constant. Here the value of $E_s = 0$. The supply curve in this case is parallel to OY axis.

3. **Relatively elastic Supply (E_s>1):**

   If the proportionate change in supply is more than proportionate change in the price. It is said to be relatively elastic supply. It means a little change in the price leads to more change in supply. Here, the value of E_s is greater than one the supply curve in the case upwards from left to right.

4. **Relatively Inelastic Supply (E_s <1)**

   If the proportionate change in supply is less than proportionate change in the price. It is said to be relatively inelastic supply. It means a more change in the price leads to less change in supply. Here, the value of E_s is less than one. The supply curve in this case also slopes up wards from left to right.

5. **Unitary elastic Supply:**

   If the proportionate change in the supply is equal to the proportionate change in the price. It is said to be unitary elastic supply. It means the change in the supply and change in price are same. Here the value of E_s is 1. Unitary elastic supply curve also slopes downwards from left to right.

Determinant of elasticity of supply:-

1. **Nature of the commodity:**

   If the good is durable, the elasticity of supply will be more [E_S > 1], the perishable goods have less elastic [E_P <1].

2. **Time factor:**

   In the long period the elasticity of supply will be more [E_S > 1]. In the short period, the elasticity of supply will be less [E_S<1].

3. **Availability of facilities:**

   If there are more facilities [E_S>1] (or) [E_S<1].

4. **Cost of production:**

   If the cost of production is more the elasticity of supply will be less, if the cost of production is less [E_S>1].

5. **Nature of inputs:**

   If the inputs are available in the market, there is a more elastic supply otherwise less elastic supply.

6. **Risk taking:**

   If the entrepreneur takes the risks the elasticity of supply, there will be more otherwise less.

1.3.3 Equilibrium

Equilibrium price means constant price (or) unchanged price. According to classical economists, the price of a good is determined by the combined actions of the buyers and sellers. It is nothing but the demand and supply. It is actually the price at which the quantity demanded of a commodity equals the quantity supplied. This can be explained by the following diagram:

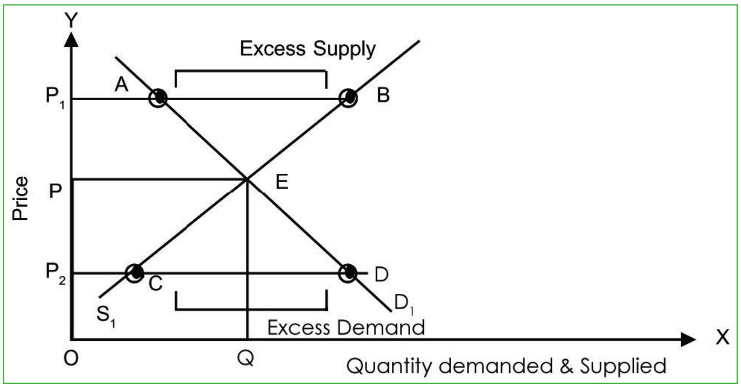


Figure: 1.22

According to the above diagram, both demand and supply are equal at OQ level. So equilibrium price is determined as 'OP'. At the price of P_1, the supply is more than the demand. At the Price of P_2 the demand is more than supply. So, P_1 and P_2 are not equilibrium prices.

Equilibrium price means constant price (or) unchanged price. But this equilibrium price can also be changed whenever there is a total change in the demand and total change in supply. This can be explained by the following cases.

Case – I

When the supply is constant, and the demand is changed, the price movements are as follows:

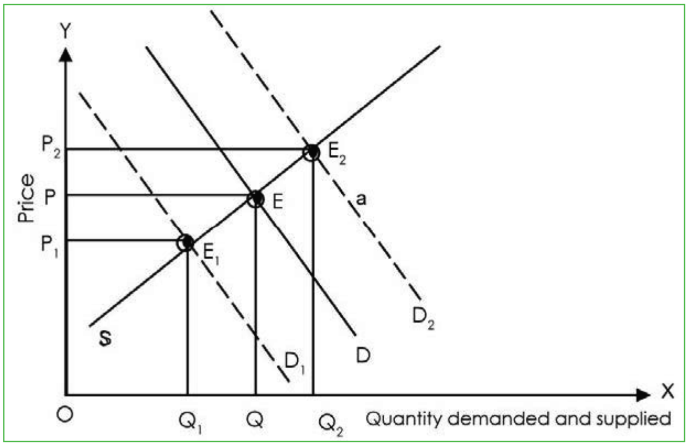


Figure: 1.23

When supply is constant, if the demand is increased equilibrium price is also increased. When the demand is decreased the equilibrium price is also decreased.

Case-II

Demand is constant and supply is changed. If the demand is constant and the supply is increased then price will be decreased and if the supply is decreased the price will be increased.

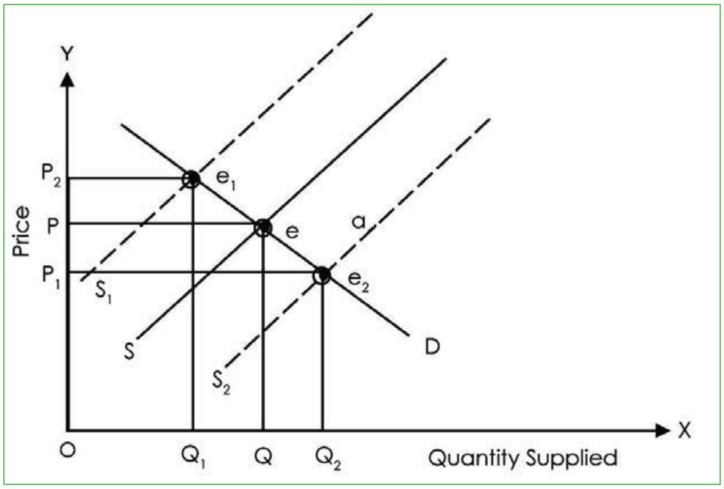


Figure: 1.24

Case-III

When both demand and supply change in the same proportion. When both demand and supply are increased in same proportion there must be not change in the equilibrium price. In the same way when both D/S are decreased in same proportion, price is at the equilibrium.

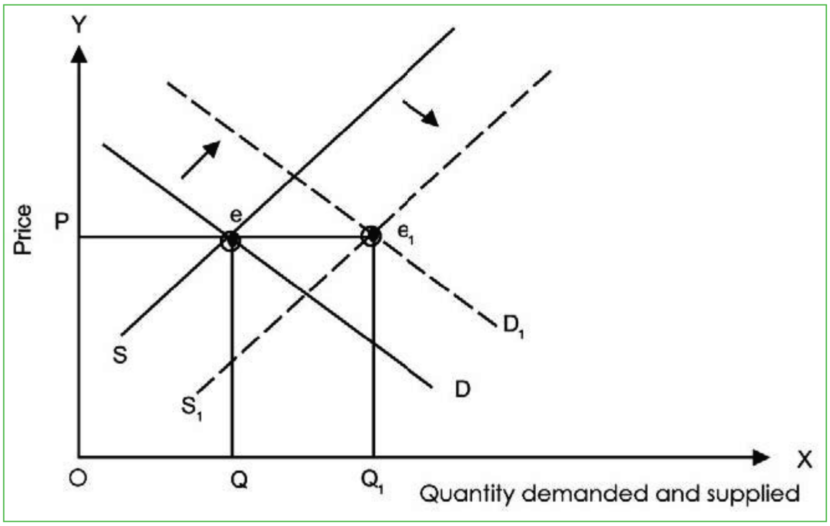


Figure: 1.25

Case – IV:

When the proportionate change in demand is more than the change in supply and less change in supply. If there is a more increase in demand and less increase in supply that leads to increase of the price.

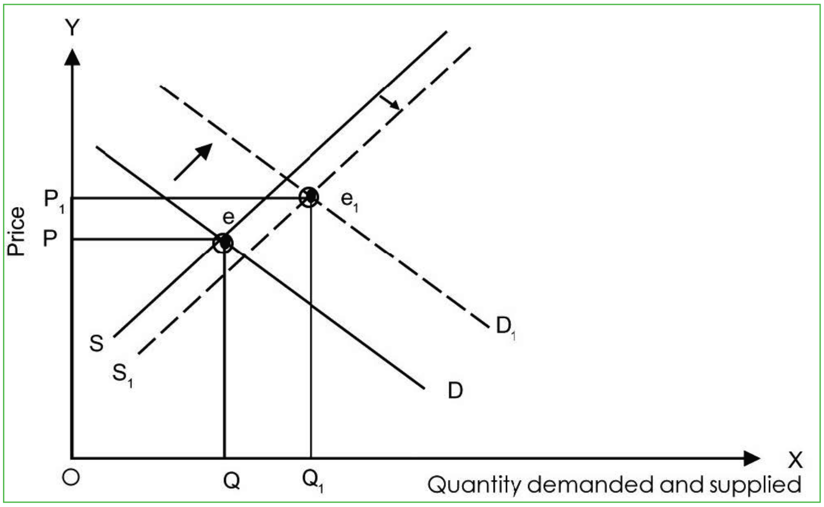


Figure: 1.26

Case – V

When the proportionage change in the supply is more than the proportionate change in demand it leads to decrease of the price.

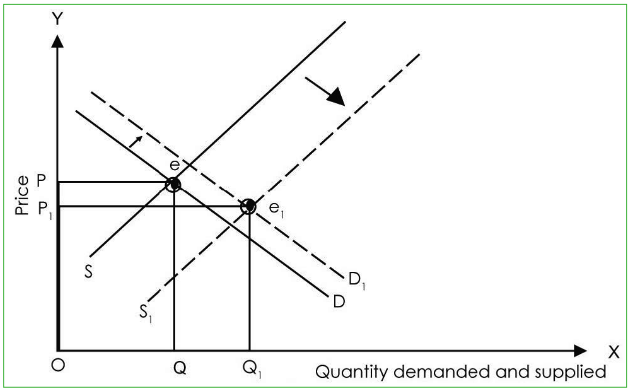


Figure: 1.27

Case – VI

When the demand is increased and supply is decreased, the new equilibrium price will be increased. In the same way, when the supply is increased and demand is decreased the equilibrium price will be decreased.

Theory of Production

1.4

1.4.1 Meaning of Production

Generally production means a process to change the raw materials into final goods (or) finished goods. But in economics making of the goods (or) creation of goods (material and non-material) for the purpose of selling them in the market is called production.

1.4.2 Factors of Production and their Classifications

Land:

Land in common usage is soil or surface of the earth. As a factor of production, it refers to all natural resources like forests, water, climate, minerals etc. It mainly supplies food to people, provides space for work and supplies raw material to industry.

Land has certain peculiar features:

1. **Gift of nature:**

   Land is a gift of nature. Location of land, deposits of minerals at certain places and Climatic conditions are no doubt gift of nature.

2. **Limited in supply:**

   The total geographical area of a country remains the same. In fact, certain resources like oil, gas, coal and some species of wild life may not be available after some time.

3. **Immobile factor:**

   Land cannot be moved from one place to another like other factor. However, its ownership can be transferred and its use can be shifted from one crop to another crop.

4. **Diminishing returns:**

   Early economists held the view that land is subject to the law of diminishing returns. Increased use of capital and labour on any given quantity of land would give us diminishing returns.

5. **Land differs in fertility:**

   There will be differences in fertility of land. As a result, the output changes from one plot to the other. It is because of these peculiarities of land, the early economists considered land as a separate factor of production.

Labour

In the ordinary usage, labour stands for only physical labour. In economics, labour means physical as well as mental services engaged in production to earn income. Classical economists and Karl Marx have considered labour as the sole factor of production.

Features of Labour:

Labour as a factor of production possesses certain peculiar features:

1. **Labour is inseparable:**

   Labour is inseparable from labourer but in the case of other factors i.e. land and capital are separable from land lord and capitalist.

2. **Labour is perishable:**

   If a worker does not find work on a particular day, the labour is lost for that day. Like other factors of production, labour cannot be preserved.

3. **Supply of labour:**

   Labourers offer more labour at lower wages. When wages rise beyond a certain level they prefer to enjoy leisure and supply less labour. It is observed that supply curve of labour is backward bending at higher wages.

4. **Weak-bargaining power:**

   Labour has less bargaining power as it is a perishable thing. In the same way the trade unions are not strengthened so they cannot fight for better wages.

5. **Differ in efficiency of labour:**

   Some labourers have more efficiency and some labourers have less efficiency.

Capital:

In the ordinary sense capital means money for an individual or a firm. Money is a form of capital when it is used to purchase machinery, tools, raw materials etc. Ultimately it is these man made goods i.e. Machinery, tools etc. that help in the production of goods. These are vital in raising productivity in different sectors.

Functions of capital:

Capital performs certain important functions in production such as:

1. **Capital supplies tools and machines:**

   Capital supplies tools and machines that assist the labourers in working efficiently and producing maximum output. A labourer backed by better tools and machines will be more efficient in production.

2. **Improves productivity of labourer:**

   Capital improves per capita productivity of labourer. This in turn increases the overall production.

3. **Capital supplies raw materials:**

   Capital supplies raw materials, which is required on a continuous basis for production of goods.

4. **Generate more employment:**

   Additional tools and machines generate more employment to people. However, in the modern production labour replacing machines reduce employment opportunities.

5. **Provides transport facilities:**

   Capital in the form of roadways, railways, ships help to transport raw material to the site of the production and finished goods to the market.

6. **Payments of factor:**

   Capital in the form of money is useful for the payment of advance wages to the labourers. Even before the goods are sold in the market.

Entrepreneur:

The person who organizes the production is called an entrepreneur. He is considered as a separate factor because he performs specific functions different from those of other factors. Now-a-days an entrepreneur is not considered as a separate factor but as special type of human labourer. Whenever the ownership and the management are one and the same entrepreneur has to perform certain specific functions.

Functions of the entrepreneur:

1. **Initiation the Business:**

   Entrepreneur has to initiate the business by mobilizing other factors. All the primary work to start the business will be undertaken by him.

2. **Decision making:**

   Major decisions like the kind of good to be produced, size of the unit, quantity of output, price, marketing etc. have to be made by him.

3. **Choosing the technology:**

   Choosing suitable technology, combining factors in right proportion to maximize output at minimum cost are the other functions of organizer.

4. **Innovation:**

   He must be dynamic to introduce new methods, techniques, products etc.

5. **Pay the rewards of factors:**

   An entrepreneur has to pay the rewards to other factors. He has to bear the responsibility either for profit or loss in production.

1.4.3 Laws of Production

Laws of Production in economics deals with the concepts of cost and producer's equilibrium. It is an important aspect of economics as it helps a business to determine the level of output that leads to maximum profits. It also defines the various variables and fixed costs of the firm.

What are the basic laws of production?

The two basic laws of production are as follows:

a. Law of variable proportion &

b. Law of return to scale.

a. Law of variable proportion

It explains the relationship between inputs and outputs in the short period. According to this law, output can be changed by changing some factors (variable factors) while other factors are constant. So it is called law of variable proportions. This law was developed by **"Alfred Marshall"**.

Definition:

"An increase in the amount of labour and capital applied in the cultivation of land causes in general a less than proportionate increase in the amount of output raised unless it happens to coincide with the improvements in the arts of agriculture". **– Marshall**

Product Concepts in this law:

Total product:

(1) Total Product - It refers to the total output of the firm per period of time

(2) Average Product - Average Product is total output per unit of the variable input. Thus Average Product is total product divided by the number of units of the variable factor.

AP = Q/L where Q is Total Product, L is the quantity of labour.

(3) Marginal Product - Marginal Product is the change in total product resulting from using an additional unit of the variable factor.

MP = dQ/dL, where d is the rate of change

It is the total amount of the output obtained by the firm 'or' producer by the employment of total units of factors of production (labour). When the marginal productivities of labour added then total productivity can be obtained

$$TP = f[ql] \text{ (or) } TP = \sum MP$$

Average Product:

It is the product per unit of labour when the total product is divided with no. of units of labour.

$$AP = \frac{TP}{L}$$

Marginal Product:

It is an additional product obtained by the firm or producer by the employment of additional unit of labour or one more unit of labour. The change in the total product is also called marginal product.

$$MP = \frac{\Delta TP}{\Delta L}$$

$$MP = TP_n - TP_{n-1}$$

Explanation of the law

Marshall explained this law with an example. He applied this law in the cultivation of land. According to this law, when land is kept as constant and the labour goes on increasing in the first stage, it gives increasing returns and after a certain stage it starts deminishing. When the labour becomes relatively abundant, the marginal product may become negative. This can be explained by the following table.

Units of labour	Total product	Average product	Marginal product
1	10	10	10
2	22	11	12
3	36	12	14
4	48	12	12
5	55	11	7
6	60	10	5
7	60	8.6	0
8	56	7	-4

Diagrammatic explanation:

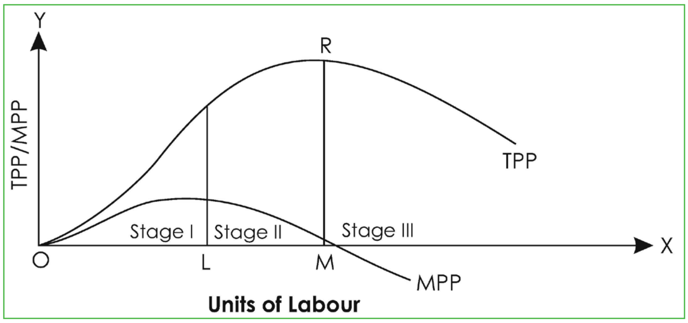


Figure: 1.28 Units of Labour

Main points in this law:

- In the 1st stage, the T.P, A.P,M.P go on increasing but at the end of the 1st stage M.P starts to decline. The 1st stage ended when the M.P is equal to A.P.
- In the 2nd stage T.P goes on increasing but it increases with diminishing rate. A.P goes on diminishing. M.P also goes on diminishing at the end of the 2nd stage the T.P reached the maximum. When the T.P is maximum then the M.P is zero. It intersects the x-axis.
- In the 3rd stage the T.P and A.P go on diminishing but for the M.P becomes negative so the M.P curves crossed the x-axis.
- The M.P curve intersects the A.P curve when the A.P is maximum.
- The law of variable proportions is also called “law of diminishing marginal returns”.
- This law is not only applicable to agriculture sector but also applicable to industrial sector, service sector etc.

Reasons for the diminishing returns:

- All units of variable factors are not homogenous.
- Imperfect substitutions.
- The combination becomes wrong.

Importance:

- This law is useful to firm (or) producer for the decision making regarding the output.
- According to this law the firm (or) producer operates only in the second stage. He never chooses either the first stage (or) third stage.

Assumptions:

- The units of the variable factor are homogenous.
- There is a possibility to change some factors (Variable factors), while other factors are constants (fixed factors).
- There is a possibility to change the combination of fixed and variable factors.
- There must be no change in the level of technology.
- It is applicable to only short period.

b. Law of Return to Scale

It shows the relationship between inputs and outputs in the long period. The change in the quantity of the factors is called scale. But, all the factors of production must be changed multiple times. For example, all the factors of production are doubled or tripled. This is done to carry out large scale production. If all the factors of production are halved or changed to one-third, it is said that the production is carried out in a small 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:

This law explains the proportional change in output with respect to proportionate change in inputs. 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

This can be explained by the following table

Scale of production	Inputs (Land + Labour)	Total Productivity	Marginal Productivity
A	1+2	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

From the above table, all inputs are changed in equal quantities or scale is changed at equal rates. Changes in output can be observed from total and marginal returns & output changes are identified 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 fourth & fifth, output has increased in the same proportion given constant returns & later similar change in inputs are giving diminishing returns.

Diagrammatic explanation:

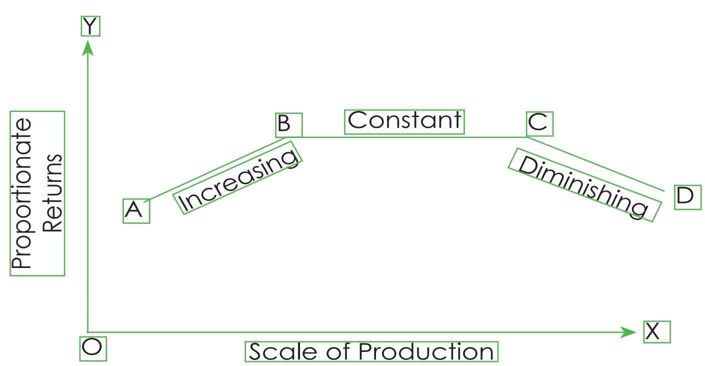


Figure: 1.29

In the above diagram scale or combination of inputs are presented on OX-axis and Marginal returns on Y-axis. As inputs are increased in the first part marginal returns curve rising i.e., they produce. In the next part the curve is stable showing constant returns finally further increase in input is resulting in decreasing returns.

Increasing returns to scale:

If the proportionate increase in the output is more than proportionate increase in the inputs it is said to be increasing returns to scale. It means when we double the inputs the output will be more than double.

Cause for increasing returns:

1. Specialization (or) Division of labour
2. Indivisible factors.
3. Dimensional economics and positive economies of scale
4. Volume discounts etc.,

Constant returns to scale:

If the proportionate increase in the output and proportionate increase in the inputs are same it is said to be constant returns to scale. It means when we double the inputs the output also will be double. There are no causes for constant returns. It is just an indicator for the ending of increasing returns and commencement of diminishing returns.

Diminishing returns to scale:

If the proportionate increase in the output is less than proportionate increase in the inputs it is said to be diminishing returns. It means when we double the inputs the output will be less than double.

Cause for diminishing returns:

1. Management problems and diseconomies of scale.
2. Limit to human factor
3. Lack of co-operation and co-ordination
4. Rise of the prices of inputs

Distinction between Returns to a Variable Factor (or Law of Variable Proportions) and Returns to Scale

The main differences between returns to a variable factor and returns to scale are indicated below:

Returns to a Variable Factor	Returns to Scale
1. Operates in the short run or it is related to short-run production-function.	1. Operates in the long-run or it is related to long-run production-function.
2. Only the quantities of a variable factor vary.	2. All factor-inputs are varied in the same factor proportion.
3. There is change in the factor-proportion. Suppose on 1 acre land 1 labour is employed, then the land labour ratio is 1 : 1. Now if we add one more unit of labour on the 1 acre land, then land-labour ratio would become 1 : 2.	3. There is no change in factor-ratio. For instance, if a firm is employing 1 unit of labour and 2 units of capital, then the labour-capital ratio is 1 : 2. Now if the firm increases its scale of operation and employed 2 units of labour and 4 units of capital, the labour-capital ratio still remains the same as 1 : 2.
4. No change in the scale of production. Because here all the factor-inputs are not changed.	4. There is change in the scale of production because here all the factor-inputs are varied in the same proportion.

1.4.4 Production Functions

Production function expresses the relationship between the physical inputs and physical output of a firm for a given state of technology. The production-function is a purely technical relation that connects factor-inputs and outputs.

The production-function can be written mathematically as follows:

$Qx = A . f (F_1, F_2, F_3 \ldots\ldots\ldots\ldots\ldots\ldots Fn)$

Where, A is the efficiency parameter which reflects the change in technology. If technology improves, the value of A increases and with the same amount of inputs it will be possible for the producer to produce more output.

Here, Qx = the quantity of x commodity

$F_1, F_2, F_3 \ldots\ldots\ldots F_N$ = different factor-inputs.

This equation tells that the output of x depends on the factor $F_1, F_2, F_3 \ldots\ldots\ldots F_n$, etc,

There is functional relationship between factor-inputs and the amount of goods x.

Types of production functions:

Before analyzing the types of production-function it will be useful to understand the meaning of the following important terms :

1. **Short period production functions:**

   It shows the relationship between production and factors of production in the short period. In the short period all factors may not be available, so the factors of production in the short period can be divided into two types. They are:-

   1. Fixed factors
   2. Variable factor

   1. **Fixed factors:**

      The factors which are not available in the short period they can be kept as constant. So they are called fixed factors.

      Example: land, building, machines etc.

   2. **Variable factors:**

      The factors which are available to change the output in the short period.

      Example: capital, labour, raw materials etc.

3. **Long period production function:**

   It explains the relationship between production and factors of production in the long period. It is also called as law of return to scale. Here the production system is guided by the laws of returns of scale.

   - The classification of fixed and variable factors is related to only short period. But in long period all factors are variable factors.

Cost of Production

1.5

Cost of production refers to the total cost incurred by a business to produce a specific quantity of a product or offer a service. Production costs may include things such as labor, raw materials, or consumable supplies. In economics, the cost of production is defined as the expenditures incurred to obtain the factors of production such as labor, land, and capital, that are needed in the production process of a product.

1.5.1 Concept of Cost

The concept of cost is a key concept in Economics. It refers to the amount of payment made to acquire any goods and services. In a simpler way, the concept of cost is a financial valuation of resources, materials, risks, time and utilities consumed to purchase goods and services.

Types of Concepts of Cost:

1. **Real cost:**

   The concept of real cost was introduced by Alfred Marshall. Exertions of all kinds of labour that are already indirectly involved in production process. All these efforts and sacrifices together will be called as real cost of production. For example exertions of all kinds of labour, waiting and sacrifices required for saving the capital.

2. **Economic costs:**

   Total expenses incurred by a firm (or) producer in producing a commodity are called economic costs. These economic costs include

   (a) Explicit costs

   (b) Implicit costs

   (c) Normal profit.

   Explicit costs:

   Actual payments made by a firm for purchasing or hiring resources are called explicit costs. These costs are actual money expenses directly incurred for purchasing the resources for example rent to the land, wages to the labourer, expenditure on raw material interest on borrowed money etc.,

   Implicit costs:

   These costs are imputed costs of the factors of productions owned by the producer himself which are generally left out in the calculation of expenses of the firm. For example, rent for the use own land, interest on his own capital etc.

   - Explicit costs are recorded in the account books but implicit costs are not recorded.
   - Explicit costs are also called "Accounting costs"

   Normal profits:

   The minimum amount which is required to keep an entrepreneur in the production process is known as normal profit.

   - Economic cost = Explicit cost + Implicit cost + normal profits.

3. Opportunity cost:

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 forego the another commodity. This is called opportunity costs.

Suppose a piece 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.

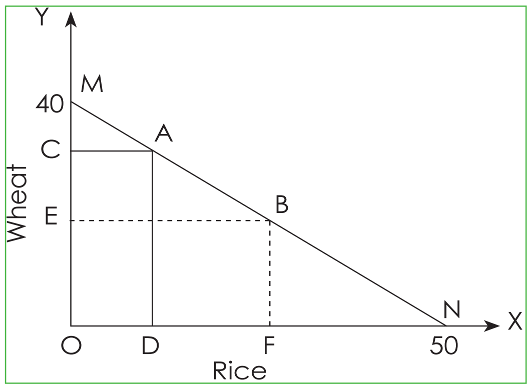


Figure: 1.30

Suppose the farmer, using a piece of land can be produced 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 form OD to OF. It means the opportunity cost of DF amount of rice is the CE amount of wheat.

Applications of Opportunity cost

The concept of opportunity cost has been widely used by modern economists in various fields.

a. Determination of factor prices:

The factors of production need to be paid a price that is at least equal to what they command for alternative uses. If the factor price is less than factor's opportunity cost, the factor will quit and get employed in the better-paying alternative.

b. Determination of economic rent:

The concept of opportunity cost is widely used by modern economists in the determination of economic rent. According to them economic rent is equal to the factor's actual earning minus its opportunity cost (or transfer earnings).

c. Decisions regarding consumption pattern:

The concept of opportunity cost suggests that with given money income, if a consumer chooses to have more of one thing, he has to have more of one thing; he has to have less of the other. Hence with the help of opportunity cost he decides the consumption pattern, that is, which goods should be consumed and in what quantities.

d. Decisions regarding production plan:

With given resources and given technology if a producer decides to produce greater amount of one commodity, he has to sacrifice some amount of another commodity.

e. Decisions regarding national priorities:

If a country decides that more resources must be devoted to arms production then less will be available to produce civilian goods. In this situation a choice will have to be made between arms production and civilian goods. The concept of opportunity cost helps in making such choices.

4. Private cost and social cost

Private cost means the cost of production borne by the private sector enterprise. The private sector enterprise, while maximising its profit, takes into account private cost only. However, the productive activity of any private sector firm can generate either a positive or a negative impact on the society as a whole. For example, a private firm may produce a hazardous chemical product and in the process of production, may pour the industrial waste directly into the river water without proper treatment. Any additional increment in the production of such goods in the private sector would create a Marginal External Damage to the society. If we add the value of the marginal external damage to the private marginal cost of producing that commodity, we get the marginal social cost of situation, social cost will be lower than the private cost.

In order to maximise the social welfare, the social marginal cost has to be equated to the marginal revenue. In other words, this equality of marginal revenue and social marginal cost also ensures the most efficient allocation of resources.

1.5.2 Short Run and Long Run Cost

Cost of short-run and the long-run is an economic term that describes the cost involved in the production of goods in a firm in the short as well as long period.

1. The short-run is a certain future period of production where the firm's one input of production is fixed while others are variable. The short-run does not specify the extent of time but rather is unique to the firm, industry, or economic variable. During the short-run period, the firm faces both fixed and variable costs. It differs in the long run.

2. The long-run is a hypothetical perception where all markets are in equilibrium and quantity and price are fully adjusted. During the long-run period, all the factors of production and costs involved in the production are variable. During this period, a firm can adjust its costs.

   Long run total cost refers to the minimum cost of production. It is the least cost of producing a given level of output. Thus, it can be less than or equal to the short run average costs at different levels of output but never greater.

Cost Curves

In a short period a firm has a fixed scale of plant, one short run average cost curve is corresponding to a particular scale of plant. So in short period the firm can operate on a particular scale of plant. But in the long run a firm can choose among possible sizes of plant (or) it can move from one scale of plant to another scale of plant. This can be shown by the following diagram.

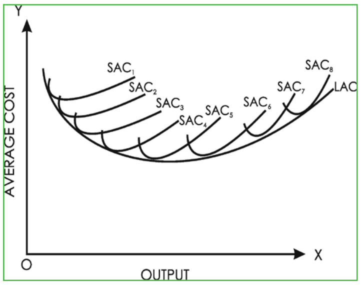


Figure: 1.31

In the above diagram there are various short run average cost curves which correspond various sizes of plant. The LAC curve will be tangent to each of the short run AC curves. It shows the least possible AC producing a quantity of the output when scale of plant is varied.

Main points:

LAC curve is 'U' shaped. LAC curve is also called planning curve and envelop curve. Like the LAC curve the long run marginal cost curve (LMC) is also 'U' shaped.

- The TC curve starts above the origin and where TFC curve is started.

TC = TFC + TVC

Output	TFC	TVC	TC
0	20	0	20
1	20	8	28
2	20	14	34
3	20	18	38
4	20	22	42
5	20	28	48
6	20	32	52
7	20	40	60
8	20	45	65

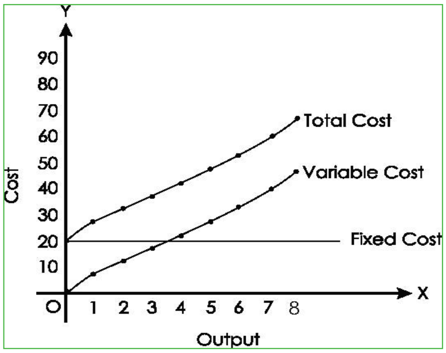


Figure: 1.32

Other cost curves in short period:

We can derive the other costs (concepts) from the above table this can be explained by the following table

Output	TFC	TVC	TC	AFC	AVC	AC	$MC = TC_n - TC_{n-1}$
0	20	0	20	-	-	-	-
1	20	8	28	20	8	28	8
2	20	14	34	10	7	17	6
3	20	18	38	6.66	6	12.66	4
4	20	22	42	5	5.5	10.5	4
5	20	28	48	4	5.6	4.6	6
6	20	32	52	3.33	5.33	8.66	4
7	20	40	60	2.85	5.71	8.56	8
8	20	50	70	2.5	6.25	8.75	10

Average cost:

It is the average total cost per unit of the output. When the total cost is divided with no. of units of outputs AC can be obtained.

$$AC = \frac{TC}{Q}$$

Or, AC = AFC + AVC

The average total cost curve is 'U' shaped

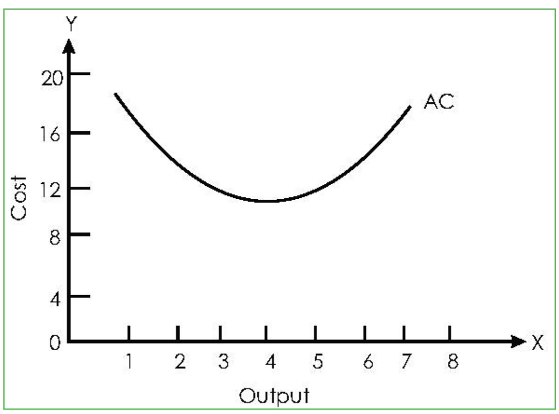


Figure: 1.33

Average fixed cost:

It is the average total fixed cost per unit of output when TFC is divided with no. of units of output AFC can be obtained

$$AFC = \frac{TFC}{Q}$$

The AFC curve slopes downwards from left to right and it is Rectangular hyperbola.

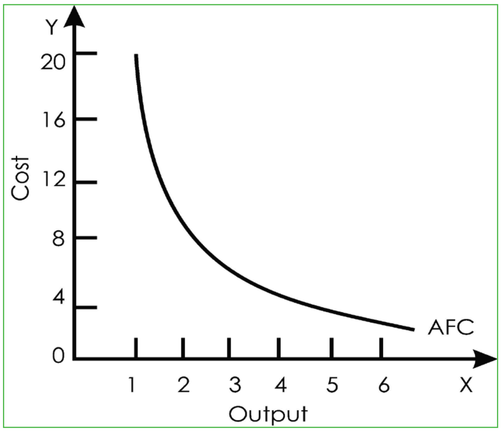


Figure: 1.34

Average variable cost:

It is the average total variable cost per unit of output when the TVC are divided with no. of units of output AVC can be obtained

$$AVC = \frac{TVC}{Q}$$

The AVC curve will be in 'U' shape

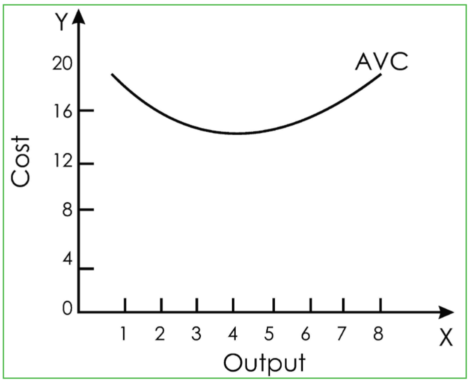


Figure: 1.35

Marginal cost:

It is the additional cost to produce the additional unit of a thing (or) one more unit of a thing. The change in the total cost is also called marginal cost.

$$MC = \frac{\Delta TC}{\Delta Q} \text{ (or) } TC_n - TC_{n-1} \text{ units}$$

Marginal cost curve is also 'u' shaped

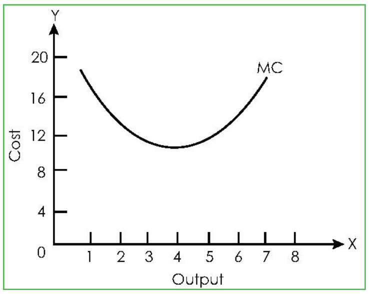


Figure: 1.36

Difference between Marginal Cost and Average Cost:

Average cost:

It is the average total cost per unit of the output. When the total cost is divided with no. of units of outputs AC can be obtained.

$$AC = \frac{TC}{Q} \text{ (or) } AFC + AVC$$

Marginal cost:

It is the additional cost to produce the additional unit of a thing (or) one more unit of a thing. The change in the total cost is also called marginal cost.

$$MC = \frac{\Delta TC}{\Delta Q} \text{ (or) } TCn - TCn\text{-}1 \text{ units}$$

The difference between MC and AC can be explained by the following diagram

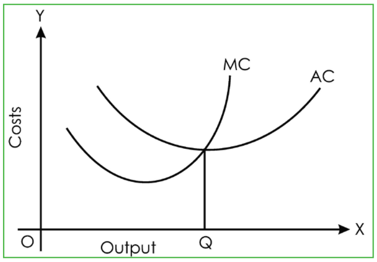


Figure: 1.37

In the above diagram in the 1st stage both MC and AC go on diminishing. The MC is less than AC, so in the 1st stage MC curve is below and AC curve is above. In the second stage when MC and AC go on increasing. The MC is more than the AC. So in this stage the mc curve is above and AC curve is below. Changes in the MC are more than changes in AC. MC curve cuts the AC curve when the AC is minimum (abnormal profits).

3. Total Costs:

When the fixed cost are added with variable costs then the total cost is obtained, when the output increases total costs also increases and when the output decreases total costs also decreases. The total cost curve will slope upwards from the left to right as there is direct relationship between output and total cost.

Short run costs:

In the short period cost of production can be divided into two types. They are

1. Fixed costs
2. Variable costs

1. Fixed costs:

The costs which don't change with change of the output are called fixed costs. It means output may be increased or decreased without change in costs. Irrespective of the Level of output Quantity the producer must incur this cost. Even if the output is zero the fixed cost is positive. The fixed cost curve (TFC) will be parallel to ox-axis.

Example: Expenditure on the land, building, salaries of permanent employees, interest payment, insurance premium etc.

2. Variable costs:

Costs which is changed with the change in the output quantity are called variable costs. It means when the output is increased, these costs are increased and when the output is decreased, these costs are also decreased. When the output is zero these costs are also zero. The TVC (Total Variable Cost) curve will be sloped upwards from "left to right" and start from the origin.

Example: Expenditure on raw material, power, fuel, wage of daily laborers etc.

Fixed costs	Variable costs
1. Fixed costs do not vary with quantity of output.	1. Variable costs vary with the quantity of output.
2. They are related with the fixed factors.	2. They are related with the variable factors.
3. They do not become zero. They remain same even when production is stopped.	3. They can become zero when production is stopped.
4. Production may not recover the fixed costs.	4. Production should at least recover the variable cost.

Cost Function

The cost function explains the functional relationship between cost of production and physical quantity of output.

$$C = f(Q)$$

Economies of Scale

Economies of large scale production:

Economies of scale are the reduction in the per unit cost of production as the volume of production increases. When the output is carried on larger quantities there are some advantages. These advantages are called economies of the large scale production. These economies are divided in to 2 types. They are:

1. Internal economies
2. External economies

Internal Economies:

When a firm expands its size of business (or) increases its output, it gets some advantages. They are called internal economies. These internal economies are related to a single firm and not related to all other firms in the industry.

Types of the internal economies:

1. **Labour economies:**

   Division of labour and specialization are possible more in large-scale operations. Different types of workers can specialize and do the job for which they are more suited. As a result of this, quality and speed of work improve.

2. **Technical economies:**

   A large firm will be able to install large capacity of machines in place of small sized machines. It also adopts latest technologies. These will give mechanical advantage over small firms and costs will be minimum.

3. **Managerial economies:**

   Highly talented managers of specialized skills will be employed by large firms. It helps to makes better decisions in the production.

4. **Marketing economies:**

   Large scale purchase of raw materials and sale of finished goods give the advantage of transport concessions to the firm. Advertisement costs will be less due to large output sales.

5. **Financial economies:**

   Large firms will be able to borrow credit easily. These firms will be able to offer securities and their goodwill in the market enables them to borrow at reasonable rate of interest. They also raise capital by attracting investors.

6. **Research and Development:**

   Improvements in technology, efficient use of resources and improvement in quality of products depend on research. Only large firms can afford to bear the expenditure on research.

7. **Economies Related to Transport and Storage costs:**

   Large firms are able to enjoy freight concession from railways and road transport as its uses its own transport means and large vehicles which results in the fall of per unit transport costs. Similarly, a large firm can also have its own storage godowns and can save storage costs.

8. **Risk bearing economies:**

   Generally, large firms diversify their production into different goods and services. Therefore, even if there is a loss in one item of good it can be covered by profit in other goods.

Internal diseconomies:

Internal diseconomies are those disadvantages which are internal to the firm and accrue to the firm when it over expands its scale of production. The main internal diseconomies of scale are as follows:-

1. **Management diseconomies**

   These diseconomies occur primarily because of increasing managerial difficulties due to large scale of operations. It becomes difficult for the top management to exercise control and to bring about proper coordination.

2. **Technical diseconomies**

   If a firm frequently changes its technologies and use new technologies and new machines, it may increase its costs. After a certain limit, the large size or volume of the plant and machinery may also prove disadvantageous.

3. **Risk bearing diseconomies**

   The business cannot be expanded indefinitely because of the principle of increasing risk. The risk of the firm increases because of reduction in demand, change in fashion and introduction of new substitutes in the market.

4. **Marketing diseconomies**

   A large firm is forced to spend more on bringing and storing of raw materials and selling of finished goods in the distant markets.

5. **Financial diseconomies**

   A large firm has to borrow a large amount of money even at higher rate of interest. It imposes a burden on the financial position of the firm.

Impact of internal economics and internal diseconomies on LAC curve:

When a firm accrues internal economies with the expansion of its scale of output, the LAC curve would fall and after a certain point, the firm receives internal diseconomies with the expansion of its scale of output, the LAC curve would rise.

Thus, internal economies causes the LAC to fall and internal diseconomies cause the LAC to rise. Hence the internal economies and diseconomies are responsible for the U-shaped of the LAC curve. It is shown in the diagram below:

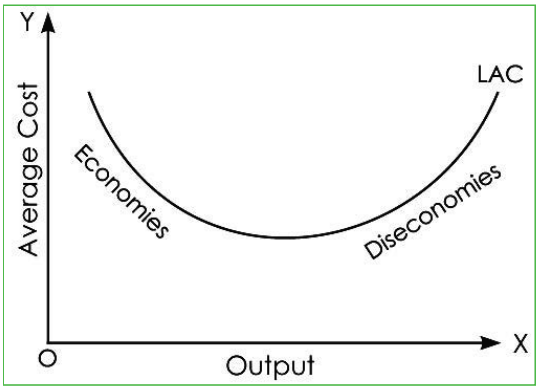


Figure: 1.38

External Economies:

Firm is a unit, the group of firms is called industry. When industry is expends there are some advantages. These advantages are enjoyed by all the firms in the industry so they are called external economies. These economics are opened for all the firms which means that they are not related to a single firm.

Types of External Economies:

1. **Economies of localization (or) concentration**

   Location of several firms at one place makes certain facilities available. Local authorities may develop roads, communication, power, irrigation etc. Other facilities like banking, insurance, skilled labour will come up in the area. These arrangements benefit all the firms located in that place.

2. **Economies of disintegration (or) specialization**

   Production of goods can be split into different parts and each firm may take up one part of producing the goods. This will result in specialization and improvement of performance of each firm in the production. This division of labour helps to produce more output and reduces costs of production.

3. **Economies of related information services**

   All the firms in the area are dealing with the same goods. Information can be shared among the firms about raw material, skilled labour, marketing etc. Expenditure on these items can be reduced and there will be mutual advantage to all the firms.

4. **Economies of producers' organization**

   Collective research by all the firms on new products, technologies will help reduce expenditure. The fruits of research can be enjoyed by all the firms.

External diseconomies:

Diseconomies which accrue to the firms as a result of the expansion in the output of the whole industry are termed external diseconomies. The main external diseconomies are as follows:

1. **Increase in the input prices**

   When the industry expands, the demand for factor-inputs increases. As a result, the input prices (such as wages, prices of raw materials and machinery equipments, interest rates, transport and communication rates etc.) shoot up. This causes the cost of production to rise.

2. **Pressure on infrastructure facilities**

   Concentration of firms in a particular region creates undue pressure on the infrastructure facilities – transportation water, sanitation, power and electricity etc. As a result, bottlenecks and delays in production process become frequent which tend to raise per unit costs.

3. **Exhaustible natural resources**

   Diseconomies may also arise due to exhaustible natural resources. Doubling the fishing fleet may not lead to a doubling of the catching of fish; or doubling the plant in mining or on an oil-extraction field may not lead to a doubling of output.

4. **Diseconomies of disintegration**

   When the production of a commodity is disintegrated among various processes and sub-process, it may prove disadvantageous after a certain limit. The problem and fault in any one unit may create limit. The problem and fault in any one unit may create problem for whole of the industry, Coordination among different concerns also poses a problem.

Impact of external economies and external diseconomies on LAC curve:

(i) As a result of external economies, the LAC curve of the firms shifts downwards. LAC curve shifts downwards from LAC_1 to LAC_2 in the diagram given below:

(ii) As a result of external diseconomies the LAC curve of the firms shifts upwards. LAC curve shifts upwards from LAC_1 to LAC_3.

(iii) Further along a same LAC, the declining part is for economies of scale and rising part is for diseconomies of scale.

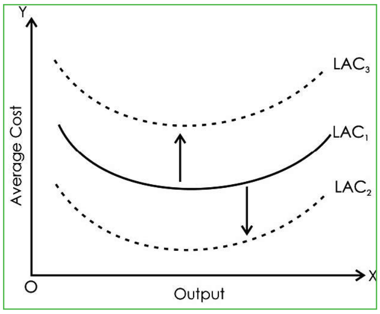


Figure: 1.39

Concepts of Revenue

It is the income obtained by the firm or producer by the sale of goods and services in the market. There are three concepts in revenue. They are:

1. Total Revenue:

It is the total amount of income obtained by the firm 'or' producer by the selling of total goods and services in the market. The sum of all marginal revenue (MR) is also called total revenue.

$$TR = PXQ$$

(or)

$$TR = \sum MR$$

2. Average Revenue:

It is the revenue per unit of output to be sold in the market. When the total revenue divided with no. of units of output, AR can be obtained.

$$AR = \frac{TR}{Q}$$

3. Marginal Revenue:

It is the additional revenue obtained by the firm (or) producer by selling additional unit of a thing (or) one more unit of a thing. The change in the total revenue is also called marginal revenue

$$MR = \frac{\Delta TR}{\Delta Q}$$

(or)

$$MR = TR_n - TR_{(n-1)} \text{ units}$$

Revenue curves under different markets:

The revenue curves are different from one market to another market. They are in one type in perfectly competitive market and another type in imperfectly competitive market.

AR and MR curves under Perfectly Competitive market

In perfect competition market in brief, the price is constant as the goods are homogeneous. So how the AR and MR are changed when the output is increased is shown in following table:

Output	Price	TR	AR	MR
1	10	10	10	10
2	10	20	10	10
3	10	30	10	10
4	10	40	10	10
5	10	50	10	10

From the above table AR and MR curves can be drawn as below:

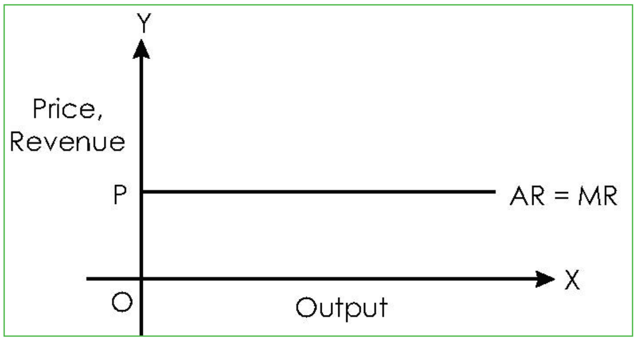


Figure: 1.40

In the above diagram AR = MR curve is parallel to OX-axis. Because the price is constant in this market.

MR and AR curves under Imperfect market:

In imperfect market, the price is changed. When the seller wants to increase the sales he must reduce the price. When the price is decreased, then the average revenue and marginal revenue are also decreased. This can be shown by the following schedule.

Output	Price	TR	AR	MR
1	10	10	10	10
2	9	18	9	8
3	8	24	8	6
4	7	28	7	4
5	6	30	6	2

From the above table AR and MR curves can be derived. This can be shown by the following diagram.

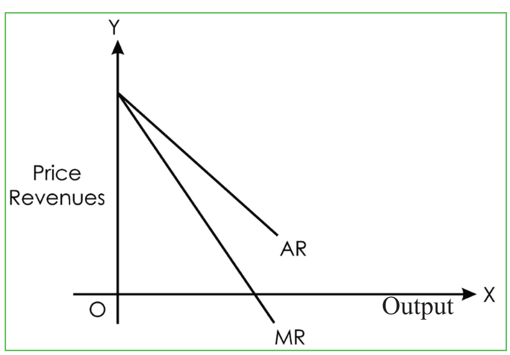


Figure: .1.41

- In imperfect market both MR and AR curves slope downwards, from left to right. Here the MR curve is below the AR curve.
- The price is always equal to "Average revenue" (P = AR) in all markets. Also MR is half of the AR.

Means of Production

1.6

1.6.1 Meaning

In a production system so many factors are used to get output. The factors are called inputs and the final outcome is the output. Output is the transformed form of the inputs. If we go to the primitive age, there was only land and labour that were used in production of agricultural goods and some small industrial/factory goods. As the civilization process improved the nature of the inputs get changed and items of inputs are also increased. In a modern production system, usually there are four factors of production, land, labour, capital and organization.

Means of production originally comes out of Karl Marx idea on mode of production. The labour as the factor is given importance and are compared with the physical capital goods like machineries, tools, etc. As such, the means of production may be referred both to tangible aspects, such as physical raw materials, tools, or labour, and non-tangible aspects such as domestic labour or knowledge production that contributes to the means of production.

Means of production, also known as means of labour, are the materials, tools and other instruments used by workers to make outputs. This includes machines, tools materials, plant and equipment, land, raw materials, money, energy, and anything else labor needs to make things. This shows that labour is at the centre stage of the production system. If labour is taken off from the production system, even with all available other factors, there will be zero production. From the importance of labour, the labour theory of value is developed. According to this theory, the value of labour should be equal to the additional value of the output after deducting the uses of other materials. But this surplus value is actually appropriated by the owner of production. This is well known as labour exploitation. According to Marx, the exploited persons are called proletariats.

1.6.2 Ownership of Means of Production

There are usually three forms of economic systems, Capitalistic, Socialistic and Mixed. Under the capitalistic system, only the private investors or business houses control the system on the basis of the market rule, there is no need of the government sector in the economic and business sectors. Capitalism is defined as private ownership and control over the means of production, where the surplus product becomes a source of unearned income for its owners. Under this system, profit-seeking individuals or organizations undertake a majority of economic activities. The market mechanism decides the prices of the goods and factors of production in this system. In the market for goods there are demanders and suppliers who interact with each other. If demand power is equal to the supply power, then there will be equilibrium in the market which will lead to the determination of the stable price of the goods. On the other hand, if there are unequal circumstances between the demand power and supply power then there will be disequilibrium in the market and no unique price will be determined. There we see huge inequality in income and wealth distribution. Today we cannot find any such country which are purely capitalistic. However, the countries with high degrees of capitalism are the countries from the Western Europe, USA, etc.

Under the Socialistic nature, the reverse to the capitalistic system occurs. Here government or public system works without any sort of private or capitalistic firms and market mechanism. All the income and wealth of the country is of the common people or public. Socialism is a populist economic and political system based on public ownership (also known as collective or common ownership) of the means of production. Those means include the machinery, tools, and factories used to produce goods that aim to directly satisfy human needs. According to Karl Marx, Capitalist society is made up of two classes: the bourgeoisie, or business owners, who control the means of production, and the proletariat, or workers, whose labor transforms raw commodities into valuable economic goods.

Here usually no or very low level of income and wealth inequalities are observed. In the modern world, there is very hard to find any such countries having pure socialistic nature. However, the countries like Venezuela, Cuba, North Korea, China etc. do follow high levels of socialistic distribution of income and wealth of the countries.

Finally in the mixed economic system we find the combinations of capitalistic/market economics and socialistic economies. Here some forms of private initiatives and governments initiatives are found side by side. In the world today, may countries are there who follow the mixed type of economic system. For example, India, Brazil, South Africa, Bangladesh, Russia, Indonesia, etc. are such countries.

The means of production can be owned by different people in different ways in different societies. Capitalism is when the means of production are owned privately. A capitalist society has a market and its rule, where things can be sold and bought at the market determined prices. Capitalism also has wage labor, or the labour paid in wages. On the other hand, other societies can be purely socialist, meaning the means of production are owned in common, either by the workers themselves or by the state. But in case of mixed nature of the economies, the ownerships of the means of production are shared by both the state (or the government) and the private business houses.

1.6.3 Relations of Production

In the production system, the transmissions of inputs to outputs happen through relations of production. It may be technical or social. In addition, the term relations of production refer to the relationship between those who own the means of production (the capitalists or bourgeoisie) and those who do not (the workers or the proletariat). According to Marx, history evolves through the interaction between the mode of production and the relations of production. By “relations of production”, Marx and Engels meant the sum total of social relationships that people must enter into in order to survive, to produce, and to reproduce their means of life. Marx and Engels typically use the term to refer to the socioeconomic relationship’s characteristic of a specific period; for example: a capitalist’s exclusive relationship to a capital good, and a wage worker’s consequent relation to the capitalist; a feudal lord’s relationship to a feoff, and the serf’s (or villain’s) consequent relation to the lord; a slave master’s relationship to their slaves, etc. It is contrasted with and also affected by what Marx called the forces of production which refers to the combination of the means of labor with human labor power.

1.6.4 Capital as Produced Means of Production

Capital is an important factor of production. Further, to gain productivity, improved version of capital is required. By raising productivity through improved capital equipment, more goods can be produced and the standard of living can be risen. Capital goods are also sometimes referred to as the means of production because these physical and non-financial inputs create objects that can eventually be bestowed with economic value. According to Bohm Bawerk, a follower of Marx, stated that “Capital is the produced means of production”. Capital is already a produced means as other factors of production are used to produce capital in an economy.

1.6.5 Mode of Production

In the post classical age, the mode of production was different to that of the classical mode of production. Actually, the term ‘mode of production’ gained momentum with the hands of Karl Marx. Marx used the term mode of production to refer to the specific organization of economic production in a given society. A mode of production includes the means of production used by a given society, such as factories and other facilities, machines, and raw materials. In the Marxist theory of historical materialism, a mode of production is a precise combination of the productive forces which include human labour power and means of production. Classical Greek and Roman societies are the most typical examples of this antique mode of production. The forces of production associated with this mode include advanced agriculture, the extensive use of animals in agriculture, industry, and advanced trade networks.

1.6.6 Importance of Means of Production

The means of production is an idea that includes the social use and ownership of the land, labor, and capital needed to produce goods, services, and their logistical distribution. The means of production are the resources and tools that make it possible for products and services to get created. By the time of early industrial society, the means of production included the machinery and raw materials in a factory. Now it also includes offices, computers, and other technology. The factors of production are defined as the resources that are the building blocks of the economy; they are what people use to produce goods and services. If business houses can improve the efficiency of the factors of production, it stands to reason that they can create more goods at a higher quality and perhaps a lower price. Any increase in production leads to economic growth as measured by the Gross Domestic Product. Improved economic growth raises the standard of living by lowering costs and raising wages.

Exercise

Theoretical Questions

I. Multiple Choice Question (MCQ)

1. Who was the father of Economics

   (a) Marshall

   (b) Adam smith

   (c) Robbins

   (d) Keynes

2. Normative Economic theory deals with …..

   (a) What to produce

   (b) How to produce

   (c) Whom to produce

   (d) How the problem should be solved

3. Micro Economics theory deals with.

   (a) Economy as a whole

   (b) Individual units

   (c) Economic growth

   (d) all the above

4. In economics goods includes material things which …

   (a) A can be transferred

   (b) can be visible

   (c) both A & B

   (d) None

5. Human wants are

   (a) limited

   (b) unlimited

   (c) undefined

   (d) none

6. Nature of PPF curve is ….

   (a) convex to the origin

   (b) concave to the origin

   (c) both

   (d) none

7. If PPF is linear it implies …
   (a) constant opportunity cost
   (b) diminishing apart cost
   (c) Increasing opportunity cost
   (d) none
8. Any point beyond PPF is ….
   (a) attainable
   (b) unattainable
   (c) both
   (d) none
9. If an economy is working at the point left to PPF curve that shows…
   (a) Full employment
   (b) unemployment
   (c) excess production
   (d) none
10. Point elasticity was propounded by:
    (a) Adam smith
    (b) Marshall
    (c) Robbins
    (d) Keynes
11. Luxury goods have ____ degree of elasticity
    (a) High
    (b) low
    (c) Moderate
    (d) none
12. The demand for salt is inelastic, because ____________________
    (a) of low price
    (b) absence of it makes food tasteless
    (c) no substitutes
    (d) All the three
13. Price elasticity demand of product will be more elastic if it ___________________
    (a) has no substitutes
    (b) has number of substitutes
    (c) is an item of necessity
    (d) is life saving product

14. If the price of burger rises from ₹ 12 per piece to ₹ 20 per piece as a result of which the daily sales decrease from 300 to 200 pieces per day. The price elasticity of demand can be estimated as:

    (a) 0.5

    (b) 0.8

    (c) 0.25

    (d) 2.10

15. An increase in price will result in an increase in total revenue if

    (a) percentage change in quantity demanded in 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

16. If the price elasticity of demand for wine is estimated to be -6, then a 20% increase in price of wine will lead to …….. in quantity demanded of wine at that price

    (a) 12% increase

    (b) 12% decrease

    (c) 19.6% increase

    (d) 20.6% decrease

17. Which of the following is not a factor in market supply of a product?

    (a) cost of production

    (b) number of buyers

    (c) market price of the product

    (d) price of related products

18. Which of these will have highly inelastic supply?

    (a) perishable goods

    (b) consumer durables goods

    (c) Items of elite class consumption

    (d) All the three

19. The supply function of a product x is as Sx = 5px+3. Where px stand for price. The quantity supplied corresponding to price of ₹ 2 will be ……… .

    (a) 18

    (b) 13

    (c) 15

    (d) 23

20. …….. is the functional relationship between physical inputs (i.e. factors of production), and physical outputs (i.e. quantity of good / service produced)
    (a) Input- Output Function
    (b) Demand – Supply Function
    (c) Production Function
    (d) Cost Function
21. Variable factor means those factors of production-
    (a) Which can be only changed in the long run?
    (b) Which can be changed in the short run?
    (c) Which can be never be changed
    (d) Both (a) & (b) correct
22. All factor of production become variable in –
    (a) Medium – run
    (b) Short- run
    (c) Long –run
    (d) none of the above
23. What is the maximum point of TP?
    (a) When AP become zero
    (b) When MP become zero
    (c) At the intersecting point of AP& MP
    (d) None of these
24. At the point of Inflexion, TP will generally-
    (a) Show increases trend
    (b) Show decreasing or increasing trends
    (c) Equal to Zero
    (d) be negative
25. If the Marginal product of labour is below the Average product of Labour, it must be true that
    (a) The Marginal product of Labour is negative
    (b) The Marginal Product of Labour is Zero
    (c) The Marginal Product of Labour is falling
    (d) The Average product of Labour is negative
26. Why does the Law of Increasing Returns operate?
    (a) Full use of Fixed Indivisible Factors.

(b) Efficiency of Variable Factors.

(c) Need to reach the right combination

(d) All of the above

27. A Rational Producer will operate in –

(a) Stage I

(b) Stage II

(c) Stage III

(d) All of the above

28. Internal Economies and Diseconomies arise due to –

(a) Overall industry-level changes

(b) Changes at the Firm Level

(c) Both (a) and (b)

(d) Neither (a) nor (b)

29. Identify the correct statement.

(a) Average product is at its maximum when Marginal Product is equal to Average Product.

(b) Law of Increasing Returns to Scale relates to the effect of changes in factor proportions.

(c) Economies of Scale arise only because of invisibilities of factor proportions.

(d) Internal Economies of scale can accrue only to the exporting sector.

30. In the primitive age the factors used in production were mainly

(a) Capital

(b) Land

(c) Labour

(d) Both land and labour

31. Modes of production was propounded by

(a) Adam Smith

(b) Karl Marx

(c) David Ricardo

(d) Alfred Marshall

32. The labour surplus is the difference between value of output minus

(a) Values of materials used

(b) Values of fixed land used

(c) Values of capital used

(d) none

33. Socialistic nature of an economy means
    (a) income and wealth are owned by the capitalists
    (b) income and wealth are owned by the labour class
    (c) income and wealth are owned by the state and public
    (d) All
34. Capitalistic economy means where the wealth and income of the country are owned by the
    (a) state
    (b) land owners
    (c) state and public
    (d) bourgeoises

II. State true or False

1. According to Adam Smith man is economic man
2. According to Marshall Economic is normative science
3. Positive science related with J.B. Say
4. The terms micro & macro are introduced by Ragnar Frisch
5. Science is practical, but Art is theoretical
6. Positive science does not related to value judgments
7. Gross investment = net investment + depreciation
8. Consumption depends not only on present income but also future income
9. Value paradox was depicted by law of demand
10. PPC is also called PPF
11. In ordinary language demand means desire
12. Usually there is an inverse relationship between income and demand
13. Consumers tastes can influence the demand
14. Change in the demand due to the change in price is called extension of demand
15. In case of exception of law of demand of the price demand curve slopes downwards from left to right
16. Comfort goods have more elastic demand
17. Price discrimination is possible due to elasticity
18. The supply curve in case of land is parallel to x-axis
19. If there is more increase in demand and less increase in supply, then quantity and price rises
20. If there is more decrease in supply and less decrease in demand then quantity decrease and price rises

21. Production function explains the relationship between inputs and output
22. All the factors which are available in the short period are called fixed factors
23. When the marginal product is divided with number of units of labour then AP can be obtained
24. Imperfect substitution is one of the reasons for diminishing marginal returns
25. When the TP is maximum, then the AP is zero
26. The main cause for the 'U' shape of LAC curve is internal economics and internal diseconomies
27. As a reason of external economies of scale the LAC curve shifts upwards
28. In perfect market AR=MR curve is parallel to ox-axis
29. In imperfect market MR curve is a below the AR curve
30. In perfect market and imperfect market the price is equal to average revenue.
31. Means of production contains only labour
32. Socialistic economies usually have low inequality in wealth distribution
33. Mixed economy is formed by the market rule
34. Primitive society had sophisticated inputs of production
35. Mode of production is postulated by Karl Marx

III. Fill in the blanks

1. According to ___________ Economics is the study of science of wealth.
2. According to _______ definition economic is a social science.
3. According to ______ top priority is given to man.
4. According to _______ Robbins Economics must be ___ between ends.
5. Alternative uses of limited resources leads to ______
6. According to ____ definition Economics analytical science.
7. Growth definition is mostly associated with _____
8. ____ definition includes welfare definition and scarcity definition.
9. In deductive method the logic proceed from ___ to ____.
10. In inductive method the logic proceed form ____ to ____.
11. According to law of demand, there is a ___________ relationship between price and demand.
12. If two or more than two goods are used to satisfy the same want are called ________.
13. In case of inferior goods, if the income rises than the demand _______.
14. Increase in demand due to the change in other things is called _____ in demand curve.
15. Total outlay method is also called _______.

16. Monopoly fixes the fewer prices if the demand is ______ elastic.
17. If there is no possibility to postpone the consumption of the commodity than the elasticity is _____.
18. Supply curve in the case of labour is ______.
19. If the supply curve is parallel to ox-axis than the supply is _____
20. Perfectly elastic demand curve is ________
21. _________ curves never touch the ox-axis
22. Costs which do not involve any cash payment to outsides are called _______
23. Accounting costs equal to _______ costs.
24. _________ cost must be paid even if the firm's level of output is zero.
25. When the total revenue equal to economic costs then the firm will earn ________
26. TCN - TCN-1 is equal to ______ cost
27. ATC curve will be in ________ shaped.
28. The vertical difference between TVC and TC is equal to _________ cost.
29. When the AC = MC then the average cost is _______
30. Variable cost is also called _____
31. A mixed economy is formed by the presence of the market and ____________.
32. In the market economy the interactions of _________ and ________ decide price.
33. Means of production is postulated by________________.
34. Labour exploitation occurs when value of output is greater than _____________________.
35. The important role of means of production is to increase level of _________________.

IV. (a) Match the following

1.	Principles of economics	(A)	Analytical method
2.	Wealth of nations	(B)	Price theory
3.	An essay on the nature and significance of economic science	(C)	Historical method
4.	Economic an introductory analysis	(D)	Marshall
5.	Micro Economics	(E)	MRT
6.	Macro Economics	(F)	Production
7.	Deductive method	(G)	Adam smith
8.	Inductive method	(H)	P.A. Samuel son
9.	Opportunity Cost	(I)	J.H. Keynes.
10.	Creation of utility	(J)	Robbins

IV. (b) Match the following

	A		B
1.	law of demand	(A)	income demand
2.	substitution effect	(B)	movement on DD curve
3.	superior goods	(C)	Prime factor
4.	Contraction of demand	(D)	inelastic demand
5.	Decrease in demand	(E)	demand curve
6.	Durable goods	(F)	elasticity of demand
7.	Unitary elastic DD curve	(G)	Rectangular hyperbola
8.	Business decision	(H)	government policy
9.	Supply	(I)	Marshall
10.	Electricity of supply	(J)	shift of DD curve

IV. (c) Match the following

1.	Fixed factor	(A)	increasing returns
2.	Land	(B)	average cost
3.	$\sum$ mp	(C)	opportunity cost
4.	Indivisible factors	(D)	economic cost
5.	Implicit cost	(E)	LAC curve
6.	Normal profit	(F)	short period
7.	National priorities	(G)	real cost
8.	Planned curve	(H)	total product
9.	AFC+AVC	(I)	rent to own land
10.	Waiting of sacrifices	(J)	fixed factor

IV. (d) Match the Following

Column A	Column B
1. Labour Theory of Value	A. Low inequality
2. Socialistic economy	B. Proletariat
3. Capitalistic economy	C. Capital goods
4. Labour Exploitation	D. Market rule
5. Produced means of production	E. Karl Marx

V. Short Essay Type Questions (Give the answers in one (or) two sentences)

1. Define wealth.
2. What is money?
3. What do you mean by market?
4. What is the meaning of Real Investment?
5. What is Portfolio Investment?
6. What do you mean by Income?
7. Explain the law of demand and its exceptions.
8. State the determinants of demand.
9. Explain about income demand.
10. Explain about cross demand.
11. Discuss about the changes in demand.
12. Explain the types of elasticity of demand.
13. Explain the types of price of demand.
14. Explain the types of income elasticity of demand.
15. State the method of measurement of Elasticity of demand.
16. State the importance of Elasticity of demand.
17. State the determinants of Elasticity of demand.
18. What is supply and explain about the law of supply?
19. State the types of elasticity of supply.
20. State the determinants of supply.
21. State the determinants of Elasticity of supply.
22. What is demand function?
23. Define market demand scehdule.
24. What do you mean by Giffen Goods?
25. What do you mean by Conspicuous goods?
26. Define cross demand.
27. What is Arc method?
28. Define contraction of demand.
29. What do you mean by supply?
30. Define supply function.
31. Define supply of labour.
32. What is a production function?

33. What are the types of production functions?
34. What is land and explain the features of land?
35. What is labour and explain the features of labour?
36. What is capital and explain the functions of capital?
37. What is Organization and what are its functions?
38. Explain the law of variable proportions and its importance -
39. Explain the law of returns to scale -
40. What is meant by cost of production? And explain the types of costs -
41. State the importance of opportunity cost -
42. Distinguish between fixed costs and variable costs -
43. Explain about short run costs with suitable diagrams -
44. Explain about long run costs with suitable diagrams -
45. State the economics of large scale production -
46. Draw the AR and MR curves under different markets -
47. What is marginal product?
48. What do you mean by increasing returns to scale
49. Explain diminishing returns to scale.
50. What is real costs?
51. What is explicit cost?
52. What is opportunity cost?
53. What is the meaning of internal economies?
54. What is the meaning of external economies?
55. What is marginal revenue?
56. What is variable factors?
57. Define means of production.
58. Make discussions on modes of production.
59. Write notes on socialistic and capitalistic natures of the economies.
60. Explain mixed economy with suitable examples.
61. Write the importance of means of production.
62. Explain the market mechanism in the determination of price of a good.
63. What is labour surplus value? How it is related to labour exploitation? Explain briefly.
64. Write in brief the produced means of production.

VI. Essay Type Questions

1. Discuss about wealth definition.
2. Discuss about welfare definition.
3. Discuss about scarcity definition.
4. Discuss about Growth definition.
5. Distinguish between micro and macro economics.
6. State whether the subject economics is science of Art.
7. State whether the subject economics is positive or normative science.
8. Explain about the control problem of all economies.
9. Define the wealth and its types.
10. Explain the relationship between wealth and welfare?
11. What is money and state its constitutes?
12. Define the market and explain its functions.
13. What is meant by investment? And its types?
14. What is production and what are the factors of production?
15. What is consumption and its determination?
16. Relationship between income and wealth.
17. Explain the relationship about consumer's surplus.
18. Explain about the law of Diminishing marginal utility.
19. What is demand forecasting and state its methods?
20. Explain the production possibility curve.

Answer:

I. Multiple Choice Question (MCQ)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
a	d	b	c	b	b	a	b	b	b	a	c	b	a	b	a	b	a	b	a
21	22	23	24	25	26	27	28	29	30	31	32	33	34						
d	c	b	b	c	d	b	b	a	d	b	a	c	d						

II. State True or False

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
T	T	F	T	F	T	T	T	F	T	T	F	T	T	F	F	T	F	T	T
21	22	23	24	25	26	27	28	29	30	31	32	33	34	35					
T	F	F	T	F	T	F	T	T	T	F	T	F	F	T					

III. Fill in the blanks:

1	J. B. Say	2	Welfare
3	Marshall	4	Neutral
5	Problem of choice	6	Scarcity
7	P.A. Samuel Son	8	Growth
9	General to particular	10	Particular to general
11	Inverse	12	Complementary goods
13	Decreases	14	Shift
15	Total expenditure	16	more
17	less	18	backward bending
19	Unlimited	20	Parallel to ox-axis
21	AFC and TFC	22	Implicit cost
23	Explicit	24	Fixed
25	Normal profit	26	marginal
27	'U' shaped	28	Fixed
29	Minimum	30	Marginal cost
31	state	32	demanders and supliers
33	Karl Marx	34	Value of materials
35	output		

IV. Match the following

(a)

1	2	3	4	5	6	7	8	9	10
D	G	J	H	B	I	A	C	E	F

(b)

1	2	3	4	5	6	7	8	9	10
I	E	A	B	J	D	G	F	H	C

(c)

1	2	3	4	5	6	7	8	9	10
F	J	H	A	I	D	C	E	B	G

(d)

1	2	3	4	5
E	A	D	B	C

FORMS OF MARKET 2

This Module includes:

FORMS OF MARKET

Module Learning Objectives:

After studying this Module, the students will be able to –

- Appreciate various forms of market with in-depth knowledge of their characteristics, equilibrium of firms in each form in the short and long run and process of price determination to facilitate pricing decision by management in a given market microstructure.
- Develop a detail understanding of the meaning and types of price discrimination and its application in business.

Introduction

2

In this module, we are concerned with the pricing policy under different forms of the market.

Under perfect competition each firm takes the market price as given and adjusts the level of output in order to maximize profit. But perfect competition hardly exists in reality. Monopoly, monopolistic competition, discriminating monopoly and oligopoly are closer to the real world.

On the other hand, the business firms may have objectives other than profit maximization in mind, such as (i) sales maximization (ii) price stabilization (iii) increasing the market share (iv) target return on capital (v) thwarting competition and (vi) ethical pricing. Here comes the pricing strategy of the business firm.

Penetration price strategy is followed to increase the sales and subsequently to maximize it.

Frequent price fluctuations do not permit forward planning of turnover, stock, investment and finance hence price stabilization is necessary.

Size of the market is a symbol of prestige, hence increasing the market share is a coveted goal.

The rate of return must be higher than the cost of capital – this is the basic consideration for fixing a target return on capital.

Through limit pricing policy, the existing firm prevents the entry of new firms, thus thwarting competition in the market.

When firms fix moderate prices, they set ethical prices to maintain a good public image.

Finally, the oligopolists form a cartel to maximize their joint profits like OPEC countries.

Pricing of Products and Services in various Forms of Markets

2.1

Pricing Strategies in various Forms of Market

Pricing Strategies:

- **Cost-plus pricing:**

  Cost-plus pricing is the simplest pricing method. The firm calculates the cost of producing the product and adds on a percentage (profit) to that price to give the selling price.

- **Limit pricing:**

  A limit price is the price set by a monopolist to discourage economic entry into a market. The limit price is often lower than the average cost of production of just low enough to make entering not profitable.

- **Penetration pricing:**

  Setting the price low in order to attract customers and gain market share. The price will be raised later once this market share is gained.

- **Price discrimination:**

  Setting a different price for the same product in different segments to the market. For example, this can be for different classes, such as ages, or for different opening times.

- **Psychological pricing:**

  Pricing designed to have a positive psychological impact. For example, selling a profit at ₹ 3.95 or ₹ 3.99, rather than ₹ 4.000.

- **Dynamic pricing:**

  A flexible pricing mechanism made possible by advances in information technology, and employed mostly by internet based companies.

- **Price leadership:**

  An observation made of oligopolistic business behavior in which one company, usually the dominant competitor among several, leads the way in determining prices, the others go on following.

- **Target pricing:**

  Pricing method where by the selling price of a product is calculated to produce a particular rate of return on investment for a specific volume of production. The target pricing method is used most often by public utilities, like electric and gas companies, and companies whose capital investment is high, like automobile manufactures.

- **Absorption pricing:**

  Method of pricing in which all costs are recovered. The price of the product includes the variable cost of each item plus a proportionate amount of the fixed costs and is a form of cost-plus pricing.

- **High-low pricing:**

  Method of pricing for an organization where the goods or services offered by the organization are regularly priced higher than competitors, but through promotions, advertisements, and coupons, lower prices are offered on key items.

- **Marginal –cost pricing:**

  In business, the practice of setting the price of a product to equal the extra cost of producing an extra unit of output.

Meaning of market:

Market is a means by which exchange of goods and services takes place as a result of buyers and sellers being in contact with one another.

Classification of market:

On the basis of various concepts, markets can be classified into various types. They can be explained as follows:

(a) On the basis of area or locality:

Markets can be classified into three types. They are:

1. Local markets
2. National markets
3. International markets

1. **Local Market:** Sometimes a particular commodity is exchanged in the locality where it is produced. Then the commodity is said to have a local market. Vegetables, flowers, fruits may be produced and marketed in the same area.

2. **National Market:** A commodity will have national market if it is demanded and supplied by people. In different parts of the country. Commodities like wheat, sugar, cotton have national market.

3. **International Market:** If a commodity is sold and purchased in different countries it is said to have international market for example gold, silver, wheat, cotton have international market.

(b) On the basis of time element:

Markets can be classified into three types:

1. Very short period market
2. Short period market
3. Long period market.

(c) On the basis of competition among the seller or producers of firms

Markets can be classified into two types. They are

1. Perfect competition market
2. Imperfect competition market

1. Perfect Competition

In a perfectly competitive market there are numerous buyers and sellers selling homogenous products and no one is able by his own actions to influence the market price, since all have access to full and immediate knowledge of the price at which the trading is currently taking place.

Definition:

"The more nearly perfect market is the stronger tendency for the same price to be paid for the same thing in all parts of the market" **– Alfred Marshall.**

Features of Perfect Market:

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.

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.

Equilibrium of the firm under perfect Market:

We have already discussed the industry equilibrium under this market. Now we discuss the firm's equilibrium in the same market. Equilibrium means constant position (or) unchanged position. The firm reached the equilibrium position when it gets maximum output. To determine the maximum output two conditions must be satisfied. They are:

1. Marginal Cost is equal to Marginal Revenue (MC = MR)

2. MC curve cuts the MR curve from below.

The equilibrium of the firm can be shown by the following diagram.

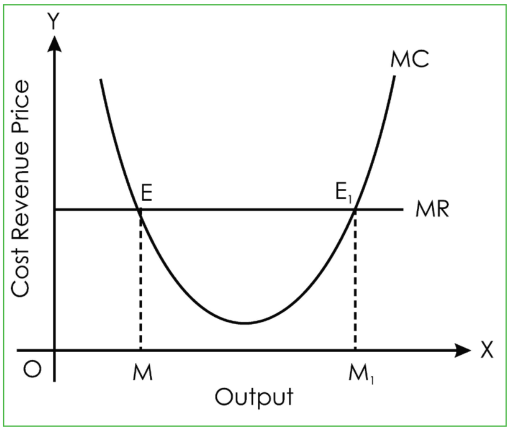


Figure: 2.1

In the above diagram output is shown on OX-axis. Costs and Revenues are shown on OY-axis. In the diagram MR is the Marginal Revenue curve and MC is the Marginal Cost Curve. MC intersects the MR curve from below at point E_1. It means at point E_1 two conditions are satisfied. So the equilibrium output is determined as M_1.

Type of Equilibrium:

The equilibrium of the firm can be divided into two types. They are:

1. Short period equilibrium and

2. Long period equilibrium.

In the short period equilibrium the firm can get either abnormal profits or losses. But in the long period equilibrium it gets only normal profits.

(a) Abnormal profits:

When the firm is in the short period equilibrium sometimes it can get abnormal profits. This can be shown by the following diagram.

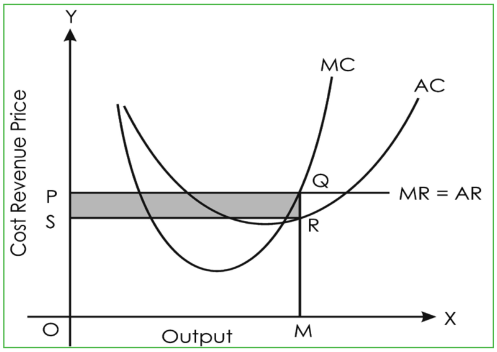


Figure: 2.2

In the above diagram output is shown on OX-axis. Costs, Revenue and prices shown on OY-axis. In the diagram MR is the Marginal Revenue curve and MC is the Marginal Cost curve. MC intersects the MR curve from below at point Q. So the equilibrium output is determined as OM at this output the price (AR) is determined as OP. The average costs (AC) is as here AR>AC. So the firm can get abnormal profits.

Abnormal profits = TR – TC

= Q x P (AR) – Q x AC

= OM x OP – OM x OS

= OPQM – OSRM

= PQRS

(b) Losses:

When the firm is in the short equilibrium sometimes it may get losses. This can be shown by the following diagram.

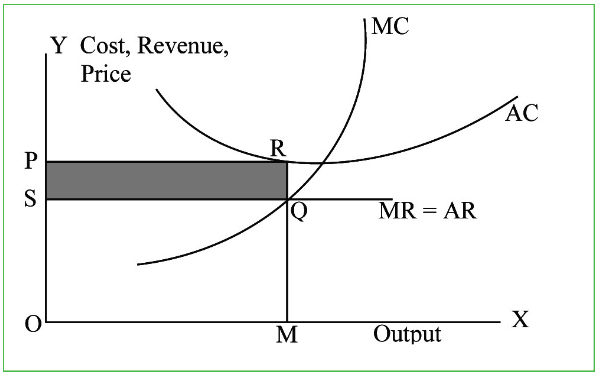


Figure: 2.3

In the above diagram output is shown on OX-axis costs, and revenues and prices are shown on OY-axis. In the diagram MR is the Marginal Revenue Curve and MC is the Marginal Cost Curve. It intersects the MR curve from below at point Q. So the output is determined as OM at this level of output. The price (AR) is OS and the average costs (AC) are OP. Here AR < AC so the firm will get losses.

Losses = TC – TR

= Q x AC – Q x P (AR)

= OM x OP – OM x OS

= OPRM – OSQM

= PRQS

Long period equilibrium – Normal Profits:

When the firm is in the long period equilibrium it gets only normal profits. This can be shown by the following diagram.

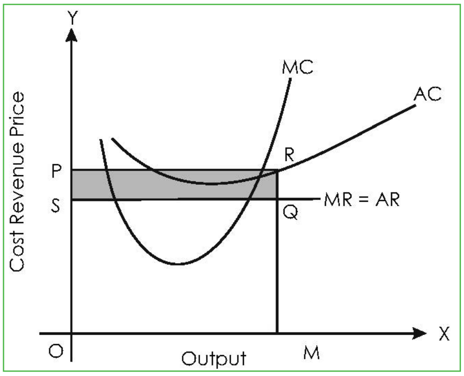


Figure: 2.4

In the above diagram output is shown on OX-axis Costs, Revenue, Price is shown on OY-axis. In the diagram LMR is the long run Marginal Revenue curve. LMC is the long run Marginal Cost Curve. It intersects the LMR from below at point Q. So the equilibrium output is determined as OM at this level of output the price (AR) is OP. The average (AC) is also OP. Here AR = AC. It means the total revenue (OPQM) is equal to total cost (OPQM). So the firm will get only normal profits. Point Q is called Break Even Point or revenue and cost equalizing point.

2. **Imperfect Competition**

Imperfect Competition Market:

The imperfect market appears in various forms. They are

1. Monopoly
2. Duopoly
3. Oligopoly
4. Monopolistic competition

1. **Monopoly Market:**

The word Monopoly is derived from two words 'Mono' and 'Poly'. Mono means Single and Poly means seller. In the market where there is only one seller or one producer or one firm it is said to be monopoly market. The single seller supply the commodity to the entire market. They are many restrictions for other producers to enter into the market as a result monopoly has no competition in the market.

Features of Monopoly:

The monopoly market has the following features:

1. **Single firm:**

   A single firm produces the commodity in the market there is only one seller or one producer or one firm.

2. **No close substitute:**

   The produce supplied by the monopolist will not have close substitutes in the market. A consumer will not find a substitutes commodity for the monopoly products.

3. **Strong barriers to entry:**

   New firms cannot enter in the production due to the certain restrictions in market i.e. huge investment, lack of technology; patents etc. prevent the new firms to enter the market.

4. **Firm and Industry are same:**

   As there is one firm in monopoly market there is no difference between firm and industry.

5. **Price maker:**

   In this market the producer can determine the price of the commodity so the producer in the market is said to be price maker.

6. **Nature of AR & MR curves:**

   The average Revenue Curve (AR) and Marginal Revenue Curve (MR) both are slopes downwards from left to right because when a seller wants to sell the more of output he must reduce the price when the price is decreased both AR & MR are declining.

7. **Price discrimination:**

   The monopolist can charge the different prices from the different customers for the same goods or services. The price is not uniform as in the perfect market competition.

8. **Maximum profits:**

   The main aim of monopoly is to earn to get the maximum profits.

Price and output determination:

In monopoly market as there is a single producer, he can control either the price of the commodity or supply of the commodity. But he can't control both at the same time. He can increase the price by decreasing the output or he can sell more output by decreasing the price. Maximization of profits is the sole objective of the monopolist. This can be shown by the following diagram.

In the below diagram output is shown on OX-axis. Cost, Revenue and Price are shown on OY-axis. In the diagram MR is the Marginal Revenue Curve and MC is Marginal Cost Curve. It intersects the MR curve at point E so the equilibrium level of output is determined as OM at this level of output the average revenue is at point Q. So the price is determined as OP the average cost is OS. Here AR > AC as the monopoly is to earn maximum profits.

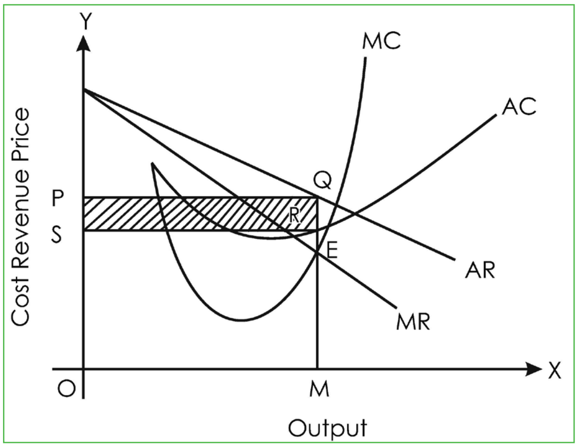


Figure: 2.5

Abnormal or super normal profits	= TR – TC
	= O x AR – Q x AC
	= OM x OP – OM x OS
	= OPQM – OSRM
	= PQRS

2. **Duopoly Market:**

   Where there are two sellers or two producers or two firms it is said to be duopoly market. It is also one of the forms of oligopoly markets.

3. **Oligopoly Market:**

   The word oligopoly is derived from two Greek words oligo and pollien, oligo means "A few", Pollien means seller. Where there are a few firms or few producers or few sellers, it is said to be oligopoly market.

   For example: automobile industry, gas industry etc.

   A market with a small number of producers is called oligopoly. The product may be homogeneous or there may be differences. Since producers are a few each firm produces a large portion of the output. It is a market with competition among the few. This market exists in automobiles, electrical and cigarettes etc.

   1. **Less number of firms:**

      The numbers of producers are a few in this market. Each one produces a large part of the total output. He can control the output in the market. A firm can change the price by supplying either more or less.

   2. **Interdependence:**

      In the oligopoly market the decisions of every producer affect other producers. This is due to less number of producers in the market. A change in the decisions of a producer (output or price) makes the other producers to change their decisions.

3. **Selling costs:**

   Sometimes commodities are produced with small differences. Then each firm makes a huge expenditure on advertisements. It is in the oligopoly that we can see the highest expenditure on selling costs.

4. **Uncertainty:**

   It will be difficult to guess what kind of demand curve will be there for a firm. Every time when a producer changes his decision, other producers will also change their decision. Therefore, it is not possible to expect price, output conditions to be the same in this market.

5. **Rigid price:**

   Usually in this market firms will not change the price, they follow a rigid price. A firm cannot increase price because other firms will not raise their prices. The firm that increases the price will be put to loss. If one firm reduces its price others will also do the same. Therefore, all the firms will follow a price without making any changes in it. Hence it is called rigid prices.

Price and output determination under Oligopoly Market:

1. **Cournot's Duopoly Model:**

   According to Cournot each duoplist believes that regardless of his actions and the effect upon the market of the product the other firm will go on producing the same commodity.

   Cournot output is two- third of the competitive output and the price is two – third of most profitable i.e., monopoly price.

2. **Stackleberg Duopoly Model:**

   The producer under duopoly structure incorporates the decision level of his rival. It then incorporates in its own profit function and thereby maximizes profit. Non-collusion is practiced at large. Leader-follower relation emerges.

3. **Bertrand Duopoly Model:**

   In the Bertrand model, the assumptions/conjectures of the model are similar to the Cournot model but the former is based upon price as the strategy variable. According to this model each producer can always lower the price until price is equal to cost of production.

4. **Edgeworth Model:**

   Each duopolist believes that his rival will continue to charge the same price as he is just doing irrespective of what price he himself sets in. No determinate equilibrium can exist under duopoly.

5. **Collusive Oligopoly:**

   According to this model a cartel is formed when firms jointly fix the price and output with a view to maximize joint profit.

   For example: OPEC countries form a cartel.

4. **Monopolistic Competition Market:**

The concepts of monopolistic competition was introduced by Prof. Chamberlin. It is a market with many sellers for a product but the products are different in certain respects. The features of monopoly and competition are combined in this market. Hence, it is called monopolistic competition. Example: Cosmetics, Soaps etc.

Characteristics of Monopolistic Competition:

The main features are:

1. **A considerable number of producers:**

   A commodity is produced by a considerable number of producers. Since there are more number of producers no one controls the output in the market. Competition will be high among the producers.

2. **Product differentiation:**

   The commodity of each producer will be different from that of other producers. The difference may be due to material used, colour design, smell, packaging, trademark etc. Because of this each product will have specific identification in the market.

3. **Entry and exit:**

   Firms are allowed to enter into production and leave the market. When profits are high new firms will join. In case of losses inefficient firms will leave.

4. **Selling costs:**

   An important feature of this market is every firm makes expenditure to sell more output. Advertisement through newspapers, journals, electronic media, sales representatives, exhibitions, free sampling help to promote the sales. Lot of expenditure is made on these items under this market.

5. **Imperfect knowledge:**

   Buyers will have an imperfect knowledge about commodities. Sometimes products may be the same but consumers think that a particular good is superior than another. Due to the advertisements and other devices consumers purchase the commodities.

6. **Price decision:**

   Each firm produces a commodity with small differences. It is due to this reason that a firm will decide the price for its product. The demand curve for a firm will be downwards sloping and more elastic.

Price and output determination under monopolistic competition market:

Demand curves:

There are two types of the demand curves under monopolistic completion markets

1. Perceived demand curve.
2. Proportional demand curve

1. **Perceived demand curve:**

   This demand curve shows the different combinations between quantity demand and price such that neither of the firms has any further initiative to deviate from their decisions.

2. Proportional demand curve

This demand curve captures the impact of the all firms simultaneously changing the same price and hence it takes into accounts the affects of the actions of the rivals.

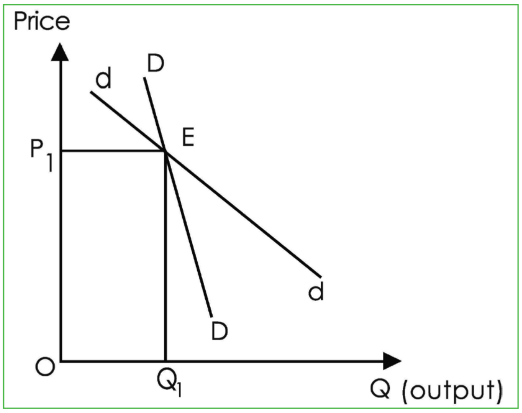


Figure: 2.6

When the perceived demand curve (dd) and proportional demand curve (DD) intersect, then the price is determined in monopolistic competition market.

Equilibrium condition under monopolistic competition:

Like the perfect competition market the firm in this market also satisfies the two conditions to reach the equilibrium position. They are

Marginal cost = marginal revenue (MC = MR)

MC curve cuts the MR curve from below

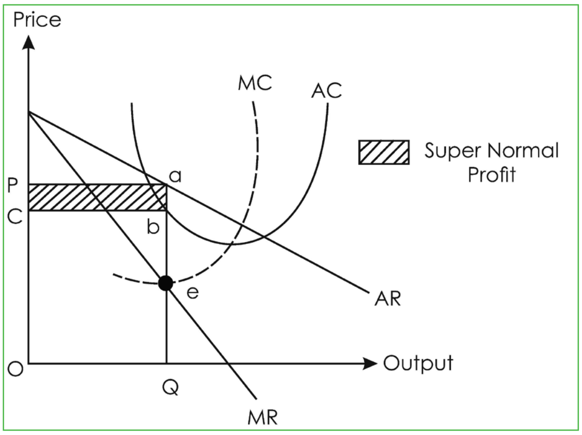


Figure: 2.7

TR = Q × P(P (AR) TC - Q × AC

= OQ × OP - OQ × OC

= OPaQ - OCbQ

Abnormal profit = Pabc

Fig 2.8 depicts the short run equilibrium situation under Monopolistic Competition. In this situation, it is possible for the firm to earn super-normal profit or abnormal profit.

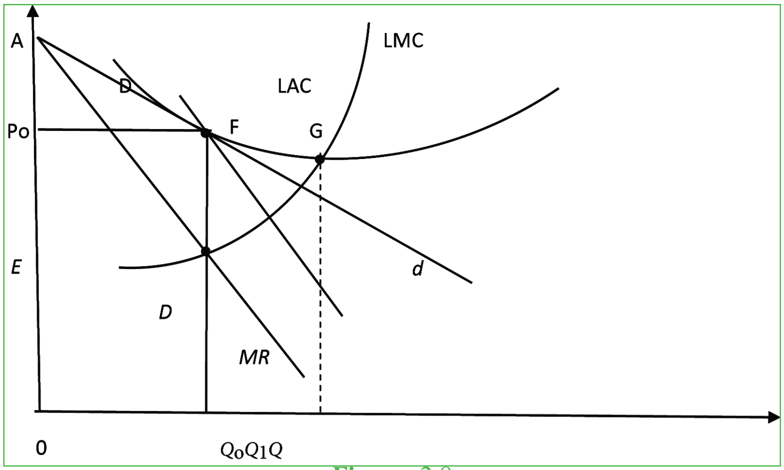


Figure: 2.8

Long-run equilibrium under monopolistic competition

Excess profits earned by each firm during the short-run would attract new firms into this market. As there is no barrier on the entry into the market, new firms can easily enter into the market in the long-run. As a result, the actual market-share of each firm will be less than before. So, the actual market-share demand curve shifts in the leftward direction. At that situation, each firm may think that, with a fall in their product price, more quantity can be sold following its perceived demand curve. Thus, in an attempt to increase the profit, a firm wants to lower the price. It expects to sell more along its perceived demand curve. A situation of price competition would arise when each firm tries to do the same thing independently.

Fig No. 5.8a shows the long-run equilibrium of a firm under monopolistic competition. The equilibrium point is E where the long-run marginal cost (LMC) curve of the firm cuts the marginal revenue (MR) curve from below. So, the long-run equilibrium output is 0Q0 and the equilibrium price is 0P0. At this output level, the actual market-share is equal to the perceived sale (i.e., P0F =0Q0).It is important to note that this profit maximising level output has been derived by equating the perceived MR and the LMC. So, in this case the perceived profit is maximised, not the actual profit. This situation is similar to that of perfect competition; but unlike the long-run equilibrium condition of a firm under perfect competition, the long run equilibrium of a firm under monopolistic competition shows equilibrium production with excess capacity.

Selling costs and monopolistic competition

The recognition of product differentiation provides the rationale for the selling expenses (particularly expenses for advertisement) incurred by any firm under monopolistic competition. The firm desires to accentuate the differences between its own brand and other brands of the product available, through its advertising and other selling activities. Thus, selling expenses have a definite role in strengthening the preferences of the consumers for the advertised product, and making the demand for the product relatively inelastic. Chamberlin argues that there are both economies and diseconomies of advertising with changes in the level of output. At the initial stage, expansion in sale will not require an equi-proportionate increase in selling expenses; and this causes a decline in spend more per unit of output to attract buyers of other varieties, and the average selling costs will rise. So, the average selling costs curve becomes U-shaped and the vertical summation of the U-shaped Average Cost (AC) curve and the average selling cost curve, would result in the true AC curve.

It operates less than its full utilization level. This call for the emgerance of the excess capacity in the market.

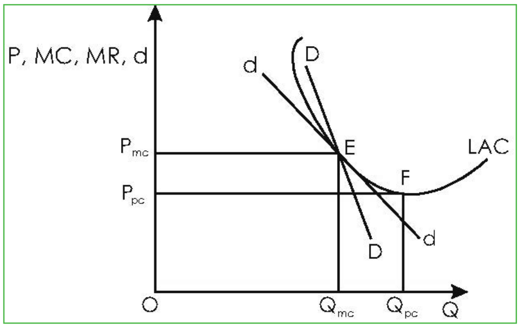


Figure: 2.9

According to the above diagram the difference between Qmc and Qpc captures the extent of excess capacity.

Price Discrimination

2.2

In a perfect situation price is decided by the market. Market brings about a balance between the commodities that come for sale and those demanded by consumers. It means the forces of supply and demand determine the price of the good. Equilibrium price is established at the point where the supply and demand are equal. A table helps us to understand and the changes in supply, demand and equilibrium price.

Price	Quantity demanded	Quantity supplied
1	50	10
2	40	20
3	30	30
4	20	40
5	10	50

The above table shows the demand and supply schedule of good. Changes in price are always causing a change in supply and demand. As price increases there is a fall in the quantity demanded. It means price and quantity demanded have negative relation. But rise I prices has increased the supply of goods. The relation between price and supply of goods is positive. Every time a change in price is causing some change in the supply as well as demand. At one price ₹ 3 it can be observed that quantity supplied and demanded are equal. This is called equilibrium price. This process is explained with the help of a diagram.

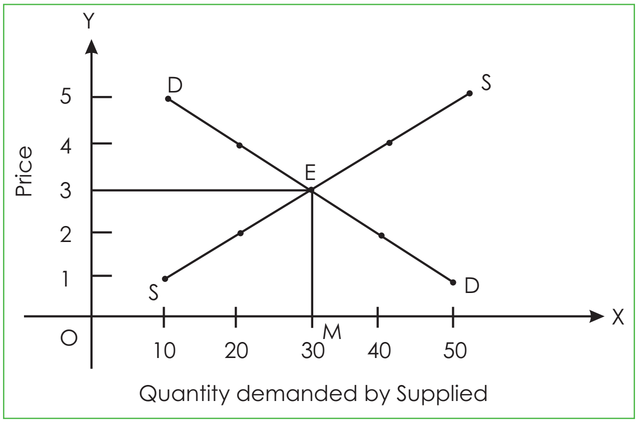


Figure: 2.10

In the above diagram demand and supply are shown on OX-axis, price is shown on OY-axis. In the diagram DD is the demand curve and SS is the supply curve. Both curves intersect at point E. It means the demand, supply are equal at OM level. So the equilibrium price is determined as OP.

Price Discrimination under Monopoly

If the seller charges different prices from the different customers for the same goods or services, it is said to be price discrimination. It is possible only in monopoly market. Hence it is called discriminating monopoly.

Classification of price discrimination:

Prof. Pigou has classified the price discrimination into three types:

1. Price discrimination of first degree.
2. Price discrimination of second degree.
3. Price discrimination of third degree.

1. **Price discrimination of first degree:**

   If the seller charges the different prices from the different customers on the basis of paying capacity of the consumer, it is said to be price discrimination of first degree. It is thus called perfect price discrimination.

2. **Price discrimination of second degree:**

   In this case the seller charges one price up to a limit of goods purchased, after that limit he charges the another prices, it is called price discrimination of second degree. It is also known as Block Pricing.

3. **Price discrimination of third degree:**

   Irrespective of the paying capacity of the consumer and quantity of the goods purchased, if the seller charges the different prices it is said to be price discrimination of third degree. The markets of the product are made different on the basis of differences in elasticity of the demand of the different markets.

The price discrimination of third degree was commonly prevailed in the society.

Conditions for price discrimination:

A monopoly firm can sell the same product at two different prices to two different groups of buyers. This type of price discrimination becomes possible under the following circumstances:

(a) Different price elasticities of demand:

The monopolist charges higher price for the product in a market where price elasticity of demand is relatively inelastic. On the other hand, he charges relatively lower price in a market where the price elasticity of demand is relatively elastic.

(b) Tariff barrier:

If two markets are separated by a tariff wall, the monopolist can follow this principle of price discrimination. For example, the monopolist can sell its product at a lower price in the foreign market, and at a higher price in the domestic market.

(c) Geographical distance between the markets:

Price discrimination is also possible when two markets are separated from one another by geographical distance. In this case, the monopolist can sell its product at a lower price in a distant market and at higher price in the local market.

(d) Impossibility of resale of a product (particular service items):

If it is not possible on the part of any buyer to resale the product sold by the monopolist, then the monopolist can easily follow the policy of price discrimination. This happens particularly in case of service items. For example, a renowned doctor can charge different fees for rendering similar service to two different patients.

(e) Ignorance of the consumers:

If the consumers remain ignorant about the difference in prices of the same product in two different markets, then also the monopolist can easily follow the policy of price discrimination.

(f) Typical behavior of the consumers:

In some cases, a group of consumers consider higher price as an indicator of higher quality (the so called Veblen effect). Such typical behavior of the consumers creates an opportunity for the monopolist to follow the policy of price discrimination.

Conditions when price discrimination is profitable

Price discrimination, though possible in many situations, need not always be profitable. The objective of price discrimination is to maximise personal profit of the monopolist. Assume that the firm produces at a single plant and supplies to two markets. We have to determine the amount of sale and the price in each of the markets so that his total profit is maximised.

Suppose the markets are 1 and 2. R_1 and R_2 are the total sales revenues from these two markets and q_1 and q_2 be the amounts sold in these two markets respectively. So the total revenue functions are

$$R_1 = R_1 (q_1) \text{ and } R_2 = R_2 (q_2)$$

Let C be the total cost of production where

$$C = C (q) = C (q_1 + q_2)$$

So the relevant profit function is $\Pi = R_1 (q_1) + R_2 (q_2) – C (q_1 + q_2)$

Thus, total profit depends on the quantities of sales in both the markets.

The necessary condition for profit maximisation is the equalizations of the marginal revenues in the two markets with the single marginal cost. That is-

$MR_1 = MC$ ………………(1)

and

$MR_2 = MC$ ……………(2)

Condition (1) shows that the monopolist will produce for the first market at such a point where the extra revenue from sale of one extra unit in the market is just equal to the extra cost of production. Similarly, condition (2) explains the optimum sale quantity in the second market in such a point that extra product cost for extra production can exactly be recovered by one extra unit of revenue from the market.

Combining (1) and (2) we get $MR_1 = MR_2 = MC$. This is the first order condition of profit maximisation under a common form of price discrimination.

The sufficient or second order condition is that the respective MR function will have lesser slopes than the MC i.e MC curve cuts both the MRs from below.

In the following diagram (Figure 2.11), the profit maximising levels of output and prices are determined under third degree price discrimination. The horizontal axis of the third plot measures total quantity of production ($q = q_1+q_2$) and sale.

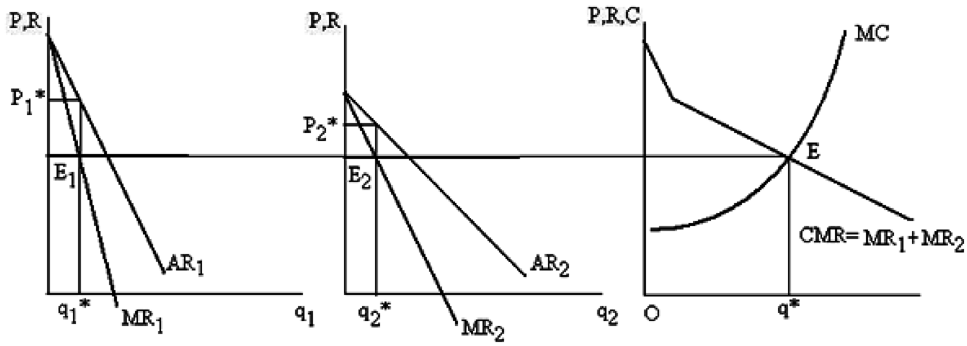


Figure-2.11

In the first and second part of the diagram, the equilibrium of the market 1 and 2 has been shown respectively. The last part of the diagram explains the equilibrium of the monopolist in total or aggregated framework.

The demand curve in 1 is less elastic than 2. The corresponding marginal revenue functions are MR_1 and MR_2. By adding them horizontally we arrive at the common MR (CMR) which is $MR_1 + MR_2$. The monopolist is in equilibrium at E where CMR = MC. Corresponding to that equilibrium in aggregate, E_1 is the equilibrium of the first market where $MR_1 = MC$. Similarly we get E_2 for market 2 where $MR_2 = MC$. The corresponding price in market 1 is P_1* and quantity sold is q_1* and for market 2, they are P_2* and q_2* respectively. The aggregate quantity sold is $q^* = q_1^* + q_2^*$. We see that $P_1^* > P_2^*$. Note that high price is charged in market 1 because of inelastic nature of the demand and lower price for relatively elastic demand for market 2.

Exercise

Theoretical Questions

I. Multiple Choise Question (MCQ)

1. Which of the following is/are an essential feature of the market
   (a) Buyers
   (b) Sellers
   (c) Price
   (d) All the three

2. In the long run price is governed by …………
   (a) Cost of Production
   (b) Demand supply forces
   (c) Marginal utility
   (d) None

3. 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

4. A firm faces the shut down situation when
   (a) Price is less than average variable cost
   (b) Price is more than the average variable cost
   (c) Price is equal to fixed cost
   (d) Price is more than the average fixed cost

5. A firm that makes profit in excess of normal profit is earning
   (a) Economic profit
   (b) Costing profit
   (c) Normal profit
   (d) Super normal profit

6. The market state that satisfy all the essential features of a perfect competitive market except identity of product is known as
   (a) Oligopoly
   (b) Duopoly
   (c) Monopoly
   (d) Monopolistic competition

7. In the short run if the price is above the average total cost in a monopolistic competitive market, the firm makes
   (a) Profits and new firms join the market
   (b) Profit and bar entry to new firms
   (c) Makes losses and exit the market
   (d) Quick profit and disappears

8. Which of these is associated with a monopolistic competitive market –
   (a) Product differentiation
   (b) Homogeneous Product
   (c) Normal in short run
   (d) Single buyer

9. In a competitive market ………. is the price maker
   (a) Firm
   (b) Industry
   (c) Consumer
   (d) Trade association

10. A Monopoly demand curve is
   (a) Same as its average revenue curve
   (b) Same as its supply curve

II. State the sentence true or false:

1. Railways is an example of perfect market
2. Sugar cane is an example of monopolistic completion
3. Free entry to exit is not the feature of monopoly
4. When MC = MR the firm will get maximum profits
5. The firm is monopoly price taker
6. Price discrimination is possible in monopoly market only
7. Pure oligopoly is one where there are few sellers producing homogeneous product
8. Kinky demand curve is the feature of monopoly
9. The firm in monopolistic competition earns abnormal profits in long run
10. The firm under perfect market earns only normal profits in the short run

III. Fill in the blanks

1. According to Adam Smith invisible hands are also called ____
2. In _____ market the firm has excess production capacity in the long run

3. If the demand curve of pure monopoly is elastic, MR will be ___________
4. Average Revenue curve is also known as ________
5. Toilet soaps industry is an example of ____ market
6. Electricity supply service is an example of ______ market
7. Price rigidity is the feature of ______ market
8. In _____ market the firm has no definite demand curve
9. The demand for monopoly product is _________ elastic
10. The demand for monopolistic completion product is _____ elastic

IV. Match the following

1.	Proportional demand curve	(A)	less price
2.	Price discrimination	(B)	duopoly
3.	Homogeneous product	(C)	advertisements
4.	Interdependence	(D)	high price
5.	Two firms	(E)	Monopoly
6.	Limit price	(F)	long period
7.	Skimming price	(G)	perfect market
8.	Selling costs	(H)	price discrimination
9.	Tariff barriers	(I)	monopolistic competition market
10.	AR=MR=P=MC	(J)	oligopoly

V. Short Essay Type Questions (Give the answer in one or two sentences)

1. What do you mean by market?
2. Explain the term Penetration pricing.
3. Explain the term Dynamic pricing.
4. What do you mean by Perceived demand curve?
5. What is Monopoly?
6. What do you mean by Product differentiation?
7. What is Selling costs?
8. What is Cost plus pricing?
9. Explain Collusive oligopoly.
10. Define Price leadership.

VI. Essay Type Questions

1. What is market? Explain the various forms of market?
2. Define perfect competition market? And state how the price is determined under this market?
3. What is monopoly? State its features and how the price and output is determined under monopoly?

4. Explain the features of monopolistic completion market?
5. State the features of oligopoly market?
6. Explain about the equilibrium of the firm under perfect market?
7. Equilibrium condition under monopolistic competition market?
8. What is price discrimination? State the types of price discrimination?
9. Discuss pricing strategies under oligopoly market?
10. Explain different pricing strategies?

Answer:

I. Multiple Choice Question (MCQ)

1	2	3	4	5	6	7	8	9	10
d	a	a	a	d	d	a	a	b	a

II. State True or False

1	2	3	4	5	6	7	8	9	10
F	F	T	T	F	T	T	F	F	F

III. Fill in the blanks:

1	Price Mechanism	2	Monopolistic competition
3	positive	4	demand curve
5	monopolistic competition	6	monopoly
7	Oligopoly	8	Oligopoly
9	less	10	more

IV. Match the following

1	2	3	4	5	6	7	8	9	10
i	e	g	j	b	a	d	c	h	f

MONEY AND BANKING 3

This Study Note includes:

MONEY AND BANKING

Module Learning Objectives:

After studying this Module, the students will be able to –

- Know the meaning, features and functions of money
- Develop and understanding about meaning and functions of banks and their role in an economy.
- Attain in-depth knowledge of the features and functions of commercial banks
- Appreciate the role of central bank in regulating money market operations including control of credit in an economy.

Introduction

3

In this module we will introduce the financial system of an economy.

In any economy, households save money from their income after consumption and put their savings in financial institutions like commercial banks. On the other hand, the business men are the investors who borrow those funds from the commercial banks. So the financial system is defined as an institutional arrangement through which funds are mobilized from the savers and transferred to the investors.

The money market is an institutional arrangement for the transaction of short term funds or short term financial assets which mature within one year, vis-à-vis, the capital market where long term funds and assets are transacted.

Government of the country enforces monetary policy through this financial system. For instance, when there is recession in the market, the government (monetary authority) brings down the rate of interest and allow credit to be given liberally to the producers. Similarly at the time of inflation, the interest rates are increased and credits are controlled.

During high unemployment, government may try to help those sectors with high employment potential by directing credit flows in these sectors.

So, business firms depend heavily on the financial system for investment which is essential for their own development and this in turn develops the entire economy.

Money - Types, Features and Functions

3.1

Before the introduction of money, barter system was in vogue or prevailed. It is an old method of exchange. People used to exchange services and goods for other services and goods in return.

Difficulties of the Barter System:

The difficulties of the barter system which may be enumerated as follows:

1. Lack of coincidence of wants.
2. Lack of store of value.
3. Lack of divisibility of commodities.
4. Lack of common measure of value.
5. Difficulty in making deferred payments.

1. Lack of coincidence of wants:

Under the barter system, the buyer must be willing to accept the commodity which the seller is willing to offer in exchange. The wants of both the buyer and the seller must coincide. This is called double coincidence of wants.

2. Lack of store of value:

Some commodities are perishables. They perish within a short time. It was not possible to store the value of such commodities in their original form under the barter system. They should be exchanged before they actually perish. Otherwise, they would not be available for exchange when the need actually arises in future.

3. Lack of divisibility of commodities:

Depending upon its quantity and value, it may become necessary to divide a commodity into small units and exchange one or more units for other commodity. But all commodities are not divisible. This is particularly true in the case of animals.

4. Lack of common measure of value:

Under the barter system, there was no common measure of value. To make exchange possible, it was necessary to determine the value of every commodity in terms of every other commodity.

5. Difficulty in making deferred payments:

Under barter system, future payment for payment for present transaction was not possible, because future exchange involved some or other difficulties. For examples, suppose it was agreed to sell specific quantity of rice in exchange for a goat on a future date keeping in view the present value of the goat. But the value of goat may decrease or increase by that date.

Functions of money

Money plays a significant role in the modern economic life of the human beings.

Evolution of Money:

The term 'Money' was derived from the name of Goddess "Juno Moneta" of Rome.

Definition of Money:

Money was invented to overcome the difficulties of the barter system. Several economists defined money in several ways:

1. **Robertson:** Robertson defined money as "anything which is widely accepted in payments for goods or in discharge of other kinds of business obligations".
2. **Seligman:** According to Seligman's definition, "Money is one that possesses general acceptability".
3. **Walker:** According to Walker, "Money is what money does".

3.1.1 Four Types of Money

In any economic system usually, there are the operations/circulations of four different types of money. They are commodity money, fiat money, Fiduciary Money and commercial bank money.

1. **Commodity Money**

   It is the simplest and the oldest type of money. It is built on scarce/valuable natural resources that act as a medium of exchange, store of value, and unit of account. Commodity money is closely related to (and originates from) a barter system, where goods and services are directly exchanged for other goods and services. Examples of commodity money include gold coins, beads, shells, spices, etc.

2. **Fiat Money**

   The term 'fiat' means a formal authorization or proposition or a decree. This means fiat money gets its value from a government order. Here the government declares fiat money to be legal tender, which requires all people and firms within the country to accept it as a means of payment. If they fail to do so, they may be fined or even put in prison. Unlike commodity money, fiat money is not backed by any physical commodity. By definition, its intrinsic value is significantly lower than its face value. Some of the examples of fiat money are coins and bills.

3. **Fiduciary Money**

   By the term 'fiduciary' it is meant the involvement of trust, especially with regard to the relationship between a trustee and a beneficiary. That is why, fiduciary money depends for its value on the confidence that it will be generally accepted as a medium of exchange. Unlike fiat money, it is not declared legal tender by the government, which means people are not required by law to accept it as a means of payment. Some examples of fiduciary money include cheques, banknotes, or drafts.

4. **Commercial Bank Money**

   It is described as claims against financial institutions that can be used to purchase goods or services. It represents the portion of a currency that is made of debt generated by commercial banks. More specifically, commercial bank money is created through what we call fractional reserve banking which is a process where commercial banks give out loans worth more than the value of the actual currency they hold. Any type of loan by the commercial banks may be termed as commercial bank money.

3.1.2 Features of Money

Components of Money Supply

Money supply includes all money in the economy. The components of money supply may vary from country to country. Broadly speaking, money supply composes of the following:

1. Currency issued by the Central Bank.
2. Demand deposits created by commercial banks.

1. Currency issued by the Central Bank:

In any country, the Central Bank issues currency. Currency consists of paper notes and coins. In India, Reserve Bank of India which is the Central Bank of the country issues notes in the denominations of ₹ 2000, ₹ 500, ₹ 100, ₹ 50, ₹ 20 and ₹ 10. The one rupee note and coins are issued by the Finance Department of the Government of India.

2. Demand deposits created by Commercial banks:

Bank deposits are a prominent component of money supply. Commercial banks create credit from the primary deposits of money received from the public. Credit is created in the form of deposits called derived or secondary deposits.

Monetary aggregates:

In India money supply is measured in terms of the following monetary aggregates:

M1 = Currency + Demand deposits + Other deposits.

M2 = M1 + Time liability portion of savings deposits with banks + Certificates of Deposits issued by banks + term deposits maturing within one year.

M3 = M2 + term deposits over one year maturity + call/term borrowings of banks. In India, mostly M3 money is used as broad money.

Value of Money:

The purchasing power of money is called value of money. It is nothing but exchange value. How much of goods and services can be obtained in exchange of a unit of money is called value of money. The value of money mainly depends upon price level. The inverse value of Price (P) is called value of money ($\frac{1}{P}$)

Types of value of money:

1. Internal exchange value
2. External exchange value

1. Internal Exchange Value:

How much goods and services can be obtained in exchange of a unit or money domestically is called internal exchange value.

2. External Exchange value:

How much foreign currency can be obtained in the exchange of a unit of domestic currency is called external exchange value.

Forms of Money:

1. Cash money and credit money.

2. Other financial assets (NBFI) e.g.:- Units of UTI, insurance policy etc.
3. Paper money and coins
4. Near money (or) money substitutes (bank cheque)

Gresham's law:

The Law states that bad money drives good money out of circulation. This is true is case of bimetallism where two metal standard (gold and silver) operated side by side. In such a case one metal currency drives the other out of circulation. It also means cheap money drives out dear money. If a country uses both money as well as metal money the people will use the paper and hold the metal money.

Quantity Theory of Money

Quantity Theory of money deals with the relationship between quantity of money and price level of economy. Here we discuss three versions of the quantity theory of money.

1. **Quantity theory by Irving Fisher:**

   The quantity theory of money explains about the value of money. Irving Fisher gave an equation to determine the value of money.

   Irving Fisher used an equation [MV = PT]

   MV = money supply.

   PT = money demand.

   Where, M = Money supply issued by the legal authority

   V = Velocity of money

   P = Price level

   T = Total output

   Fisher used the equation to show the relationship between money supply and price level as direct and proportional.

   The rate of change in money supply (dM/M) is equal to rate of change in P (dP/P).

Main points:

1. There is a direct or proportional relationship between money supply and price level.
2. There is an inverse relationship between money supply and value of money.
3. There is an inverse relationship between price level and value of money.

Assumptions of Fisher equations:-

1. (V) velocity of money is constant.
2. Gross National Product (T) is also constant
3. This theory assumes money demand for transactional purpose only.

Criticisms:

1. Fisher's equation is abstract and mathematical truism. It does not explain the process by which M affects P.
2. It is presumed that entire M is used up in buying T instantly. It is unreal. No one spends all money the moment he earns it.

3. The concept of full employment is myth. There is natural rate of unemployment in every country.
4. Even with full employment, a country can increase national output by bringing those factors which are not available within economy from abroad.
5. It is presumed that money is used for transactions only. Hence the theory is often referred to as cash transaction theory. This ignores the other roles of money.

Quantity theory of money - cash balance approach (or) Cambridge equation:-

Cambridge University professors give another equation which explains the value of money i.e.

M = PKT

M = money supply for a specific period of time

P = Price level

K = cash balance, it is the part of total income

T = Total output

However, Fisher's version and the Cambridge version of the quantity theory are not exactly the same. There is a small difference. The total transactions in the market in a year, T, may not be exactly the same as total output of the year, Y (one reason for this is that all of the output of a year may not come to the market in that year. On the other hand, a good sold in a given year may not have been produced in that year. It may be an unsold good of the previous year.)

If we ignore this small difference between T and Y (ie., if T = Y) then a comparison of the two equations MV = PT and M = KPY shows that:

K = 1/V or V = 1/K. This is because of the fact that as greater proportion of income is kept as cash balance with the public, velocity of money will fall and vice versa.

Therefore, M = KPY = 1/V . PT

Or, MV = PT

Thus, the Cambridge K and Fisher's V are the reciprocal of each other. Hence, 1/K can be taken to be the velocity of circulation of money. Strictly speaking of course, we should distinguish between T and Y. Therefore, V is called the 'transactions velocity' and 1/K is called the 'income velocity' of money.

Quantity theory by Keynes:

According to J.M. Keynes, the money supply affects the rate of interest. When the money supply increases rate of interest will be decreased. It leads to the increase of investments level of employment, income, demand, price level etc., when the price level increases there is a decrease in the value of money.

According to Keynes, the rate of interest play a dominant role in determination of value of money.

The Keynesian version of the Quantity Theory integrates monetary theory with the general theory of value.

In a broader sense, the term inflation refers to the persistent rise in general price level over a long period of time. Some of the important definitions of inflation are given below:

Definitions:

Crowther: Crowther defined inflation as a state in which the value of money is falling, that is the prices are rising.

Samuelson: According to Samuelson, "Inflation denotes a rise in the general level of prices".

Causes of Inflation:

Primary Causes:

1. When demand for a commodity in the market exceeds its supply, the excess demand will push up the price (‘demand-pull inflation’).
2. When factor prices rise, costs of production rise (‘Cost –push inflation’)

Let us now discuss in detail the various causes that may bring about inflation –

Increase in public spending:

1. Government’s spending is an important part of total spending in any modern economy.
2. It is an important determinant of aggregate demand.
3. In less developed economies, government expenditure has shown an upward trend.
4. This has created inflationary pressure on the economy.

Deficit financing of government spending:-

1. Government spending increases beyond what can be financed by taxation.
2. In order to be able to incur the extra expenditure, the government resorts to deficit financing.
3. For instance, it prints money and spends it. This adds to the pressure of inflation.
4. Production process and the supply could be increased freely, deficit financing does not lead to inflation.

Increased velocity of circulation

1. Total use of money = money supply by the government x velocity of circulation of money.
2. In boom phase, people speed money at a faster rate.
3. The velocity of circulation of money is increases.

Population growth:

1. It increases total demand in the market.
2. The pressure of excess demand will create inflation.

Hoarding:

1. Excess demand is sometimes artificially created by hoarders.
2. They stockpile commodities
3. They do not release them to the market.
4. This leads to excess demand and inflation.

Genuine shortage:

1. If the factors of production are in short supply, production will be affected.
2. Supply will be less than demand, prices will rise.

Exports:

1. If the total output of a commodity is not sufficient to meet both domestic and foreign demand.
2. Then exports will create inflation in the domestic economy.

Trade unions:

1. By demanding an increase in the wage rate, they increase the cost of production.

Tax reduction:

1. Governments sometimes reduce taxes to gain popularity.
2. This leaves more money in people's hands.
3. This leads to inflation if there is no corresponding increase in production.

Imposition of indirect taxes:

1. Government may imposes indirect taxes (such as excise duty, value-added tax etc.)
2. Then producers of sellers raise the product prices to keep their profits unchanged.

Price-rise in international market:

1. The imported price of some commodities or factors of production may rise in the world market.
2. It would lead to inflation in the domestic market.

Non-economic reasons:

1. For instance, at times of natural calamities (flood) crops are destroyed, reducing the supply of agricultural products.
2. Prices of these commodities tend to increase.

3.1.3 Functions of Money

Money has many important functions to perform. These functions may be classified as follows:

1. Primary Functions.
   (a) Medium of Exchange.
   (b) Measure of Value.
2. Secondary functions
   (a) Store of value.
   (b) Standard of deferred payments.
   (c) Transfer of money.
3. Contingent functions.
   (a) Measurement and distribution of national income.
   (b) Money equalizes marginal utilities/productivities.
   (c) Basis of credit.
   (d) Liquidity

1. Primary functions:

The primary functions of money are really the technical and important functions of money. They are of two types:

(a) Medium of Exchange:

Money serves as a medium of exchange. Money facilitates exchange of commodities without double coincidence of wants. Any commodity can be exchanged for money. People can exchange goods and services through the medium of money.

(b) Measure of Value:

The value of each commodity is expressed in the units of money. We call it the price. In view of this function of money, the values of different commodities can be compared and the ratios between the prices of different commodities can be determined easily.

2. Secondary functions:

Money has the following secondary functions:

(a) Store of value:

The value of commodities and services can be stored in the form of money. Certain commodities are perishable. If they are exchanged for money before they perish, their value can be preserved in the form of money.

(b) Standard of deferred payments:

Money serves as a standard of deferred payments. In the modern economies most of the business transactions take place on the basis of credit. An individual consumer or a business man may now purchase a commodity and pay for it in future. Similarly, one can borrow certain amount of money now and repay it in future.

(c) Transfer of money:

Money can be transferred from one person to another at any time and at any place.

3. Contingent functions:

Besides the primary and secondary functions, money has certain contingent functions also. They may be stated as follows:

(a) Measurements and distribution of national income.

National income of a country can be measured in money by aggregating the values of all commodities. Similarly, national income can be distributed to different factors of production by making payments to them in money.

(b) Money equalizes marginal utilities/productivities:

The consumers can equalize the marginal utilities of different commodities purchased by them with the help of money. They can thus maximize their satisfaction. Similarly the firms can also equalize the marginal productivities of different factors of production and maximize their profits.

(c) Basis of credit:

Credit is created by banks from out of the primary deposits of money. The supply of credit in an economy is dependent on the supply of nominal money. It is not possible to create credit if there is no reserve money.

(d) Liquidity:

Money is the most important liquid asset. In terms of liquidity, it is superior to all other assets. Money is hundred percent liquid.

Banking - Definition, Functions, Utility, Principles

3.2

3.2.1 Meaning of Banking

Definition of Bank:

Sayers define bank as, "an institution whose debts (bank deposits) are widely accepted in settlement of other people's debts".

According to Crowther, a bank "collects money from those who have it to spare or who are saving it out of their incomes and lends this money to those who require it".

Essentials of a sound Banking System:

A sound banking system promotes all round economic development of an economy. A good bank must have the following features:-

(a) Adequate Liquidity –

A bank must keep sufficient cash in hand to meet the claim of depositors, otherwise they would be insolvent. A bank's failure not only affects depositors but the bank also. People would not keep more funds with banker unless it ensures safety to its customers.

(b) Expansion of banking-

Banking facilities should spread throughout the economy. It must also cover all sections of people in need of funds and all productive activities. The less-developed regions should get more banking facilities than others. Thus, diffusion of banking offices is essential.

(c) Investment and loan policies –

A sound banking system must have a sound investment policy whereby it can optimize the twin goals of liquidity and profitability. If loan and investments are wrong, a bank suffers loss or face liquidity shortage. A prudent banker should carefully determine the composition and character of its loans and advances so as to optimize earning without endangering safety and solvency.

(d) Human factor –

The soundness of a bank depends much on the quality of banker. Banking being a practical affair, rigid application of bank laws are not always fruitful. Much depends on the discretion of men piloting the ship. Sound banking thus, depends more on banking personnel than on banking laws.

3.2.2 Functions of a Commercial Bank

Modern commercial banks perform a variety of functions and provide a number of services to their customers.

They are regarded as departmental - store banks because they provide a wide variety of services to their customers.

Various functions performed by commercial banks are as follows:

acceptance of deposits, advancing of loans, credit creation, facilitation of payments through cheques, transfer of funds, agency functions and other miscellaneous services.

Commercial Banks

Commercial Banks play a very prominent role in the financial system of an economy. They perform a variety of functions as discussed below:

1. **Acceptance of deposits:**

   One of the primary functions of a commercial bank is to accept deposits from the public. The deposits accepted by the banks are of the following types.

   (a) Current deposits:

   These are the deposits made into the current account of a bank. They are most convenient to the businessmen, public authorities and joint stock companies because there are no restrictions on the number and the amount of withdrawals.

   (b) Savings deposits:

   These deposits are made into a savings bank account of the bank. They are most convenient to the small businessman, salaried employees, artisans and people belonging to the low and middle income groups. The interest paid on these deposits is comparatively low and is around 4% per annum.

   (c) Term deposits:

   They are also called fixed deposits because the money is deposited with the bank for a fixed period of time. The deposit can be withdrawn after the expiry of maturity period. The minimum period of deposit is 15 days. The rate of interest varies from 6% per annum to 12% per annum.

   (d) Recurring or cumulative deposits:

   These are the variants of fixed deposits. These deposits are very convenient to those who cannot save huge amounts at a time. These deposits carry interest at a rate more than that of savings bank and less than that of a term deposit.

2. **Payment of loans and advances:**

   Another primary function of the commercial bank is to give loans and advances to different sections of the public like traders, industrialists, farmers, artisans etc.

   (a) Demand loans/call loans:

   A demand loan is a loan that should be repaid on demand by the bank. It does not have a specified maturity period. This loan is a kind of advance made with or without security. These are also called call loans. Normally, call loans are given to other banks or financial institutions for a day or a few days.

   (b) Short term loans:

   These loans are given for a specified short period. They are sanctioned to businessmen and farmers etc. to finance working capital. Individuals may also receive such loans as personal loans. They are given against security.

   (c) Cash credits:

   A cash credit refers to an arrangement by which the bank allows its customers to borrow money upto a specified limit from an account opened for the purpose. The customers need not withdraw the entire amount in one installment.

(d) Overdraft:

This is a facility allowed by the bank to the current account holders. They are allowed to withdraw money with or without security in excess of the balance available in their account up to a limit. Interest is charged on the amount of actual withdrawal.

(e) Discounting of bills of exchange:

Bills of exchange are undertakings written by the buyers and given to sellers when the transaction is made on credit basis. The buyer undertakes to make payment after a specified period or on a specified future date. The traders who posses such bills of exchange with them may approach the banks for discounting of the bills of exchange when they need money.

(d) Credit cards:

Now-a-days, the banks have devised new methods of giving loans to the customers. One such popular method is issuance of the credit card. A credit cardholder can use his card to purchase goods on credit from specified firms and shops and also withdraw cash subjects to certain regulations.

3. Creation of Credit:

The commercial banks create credit. This is a unique function of commercial banks. Credit is created from out of the primary deposits of money the customers received from the public. Part of the total amount of these deposits is given as loans and advances to its customers.

It should be noted that one single bank cannot create credit. Banking system as a whole consisting of several banks jointly can create credit.

4. Agency Functions:

Commercial banks perform certain agency functions also:

(a) Collection of cheques, drafts, bills of exchange etc. of their customers from other banks.

(b) Collection of dividends and interest from business and industrial firms.

(c) Purchase and sale of securities, shares, debentures, government securities on behalf of the customers.

(d) Acting as trustees and keeping their funds in safe custody, acting as executors and executing the will of the customers after their death.

(e) Making payments such as insurance premium, income-tax, subscriptions etc. on behalf of their customers as per their advice.

3.2.3 General Utility Functions

Besides the above agency functions, the commercial banks provide certain general utility services to their customers.

(a) Provide locker facility for the safe custody of the silver, gold ornaments, important and valuable documents.

(b) Transfer money of the customers from one bank to the other by way of demand drafts, mail transfer.

(c) With the use of computers and internet facility, now-a-days the banks are facilitating online transfer of money from one bank to the other.

(d) Issue letters of credit to enable the customers to purchase commodities on the basis of credit.

(e) Endorse and provide guarantee to the shares issued by the joint stock companies and help them in rising capital.

(f) Traveler's cheques are issued by the commercial banks to avoid the risk of carrying of cash.

(g) Provide foreign exchange to the customers for exports and imports in connection with their business.

(h) Convey information on behalf of their customers to the businessmen operating in other places and also collect information of such businessmen and provide it to the customers.

(i) Recently the commercial banks have been establishing ATMs (Automated Teller Machines) at different locations so as to enable their customers to withdraw cash from their accounts at any ATM at any time in a day.

3.2.4 Principles of Commercial Banks

1. **Principle of liquidity:**

   Deposits are repayable on demand or after expiry of a certain period. Everyday depositors either deposit or withdraw cash. To meet the demand for cash, all commercial banks have to keep certain amount of cash in their custody.

2. **Principle of profitability:**

   The driving force of commercial enterprise is to generate profit. So it is true in case of commercial bank also.

3. **Principle of Solvency:**

   Commercial bank should be financially sound and maintain a required capital for running the business.

4. **Principle of safety:**

   While investing the fund, banks are to be cautions because bank's money is depositor's money.

5. **Principle of collection of savings:**

   This is a very important principle for today's banking business. Commercial banks always seek huge amount of idle money from the clients. Now a day's banks fix up the target for their employees to generate more savings from the people.

6. **Principle of loan and investment policy:**

   The main earning sources of commercial banks are lending and investing money to the viable projects. So commercial banks always try to earn profit through sound investment.

7. **Principle of economy:**

   Commercial banks never go for any unnecessary expenditure. They always try to maintain their functions with economy that increase their yearly profit.

8. **Principle of providing services:**

   A better service brings great reputation for the bank.

9. **Principle of secrecy:**

   Commercial bank maintains and keeps the clients accounts secretly. Nobody except the legitimized person is allowed to see the accounts of the clients.

10. **Principle of modernization:**

    It is the age of science and technology. So, to cope up with the advanced world the commercial bank has to adopt modern technical services like online banking, credit card etc.

11. Principle of specialization:

It is an age of specialization. Here commercial banks segments their whole functions into various parts and place their human resources according to their efficiency.

12. Principle of location:

Commercial banks choose a suitable site where the availability of customers is large.

13. Principle of relation:

Commercial banks always try to maintain a good relation with their clients and potential customers.

14. Principle of publicity:

It is an age of publicity. If you would like to earn more money, you have to give more advertisement through various media. In that case, commercial banks follow this kind of principles to increase their customers.

Bank Rate Policy:

- As a banker's bank, a central bank lends money or rediscounts the bills of commercial banks.
- The rate of interest charged by the central bank is known as Bank rate or Discount rate.
- By manipulating bank rate, central bank can regulate the credit creating power of member banks.
- If bank rate is raised by the central bank, commercial banks are to borrow at a higher cost.
- Then they will increase their lending rate. This rate is known as the market rate.
- The difference between market rate and bank rate is the profit margin of commercial banks.
- When bank rate rises market rate also rises and vice versa.
- Demand for bank loan will reduce.
- On the other hand, for credit expansion, bank rate is reduced.
- The effectiveness of this technique depends on the extent to which commercial banks depend on central bank for loan and rediscounting.
- If banks can collect funds from other sources at relatively cheaper rate, they need not depend on central bank credit.
- Again if investment opportunities are not present, the market demand for credit will be weak, a fall in the bank rate may not raise the level of bank credit.

Commercial Banks and Central Bank 3.3

A commercial bank is a financial intermediary. It accepts the deposits from the surplus units and lends these financial resources to the deficit units.

Central Bank is the apex of the banking system in a country. It controls, regulates and supervises the activities of the banks and the country's banking system.

In our country, the Central Bank was established in 1935 under private management. It was nationalized by the Government in 1949 and named as RBI.

Objectives of the Central Bank:

The Central Bank functions with the objectives given below:

1. To maintain the internal value of currency.
2. To preserve the external value of currency.
3. To ensure price stability.
4. To promote financial institutions.
5. To promote economic development.

Functions of a Central Bank:

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 as the 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.

Distinction between the Central Bank and the Commercial Bank –

Basis of distinction	Central banks	Commercial banks
Monetary Authority	Enjoys supreme monetary authority with wide powers	No authority, hence no such power is enjoyed.
Profit motive	It does not exist to make profits of its for owners	It exists and is organized for profits their owners
Money supply to the economy	It is the ultimate source of money supply to the economy.	No such function is performed by it.
Services rendered	It acts as a banker to the government	It acts as a banker to private industrial and institutions
Chance of failure	It is the lender of last resort and hence never fails	It often undertakes risky business activities and sometimes may fail.
Service to the public	It neither does accept deposits from public, nor lends money to the public.	Accepting deposits and lending money to the public are the most important functions of commercial banks.
Ownership and managing authority	It is generally subordinate to the state, i.e. state owned and state managed.	It is mostly privately owned and privately managed.
Nature of operation	It issues paper notes in fact it enjoys the monopoly power in this matter	Its nature operation is credit creation and cannot issue paper notes.
Basis of operation	The basis of cash money issued is gold and foreign reserve.	The basis of credit money generated is cash deposit.

Financial Institutions

1. Industrial Finance Corporation of India (IFCI) – 1948

It was established in 1st July 1948. The main objective of IFCI is to make medium and long term credit to the industrial units.

Functions:-

1. Granting loans and advances for a period of 25 years.
2. Subscribing to the shares and debentures floated by industrials concerns.
3. Granting loans in foreign currencies.
4. Guaranteeing for differed payments in respect of import of capital goods.

2. State Financial Corporation (SFC) – 1953

The first SFC was established in 1953 in Punjab, at present there are 18 SFC's. The main object of the establishment of SFC is to meet the requirements of medium and small scale industries in various states.

3. Industrial Credit and Investment Corporation of India (ICICI) – 1955

It was established in 1955 and the main aim of the ICICI is to develop the industries under the private sectors only. It is a private bank.

4. State Industrial Development Cooperation (SIDC) – 1960

The main object for the establishment of SIDC is to achieve the rapid industrialization in the state. At present there are 28 SIDC's in India.

5. Unit Trust of India (UTI) – 1964

It was established in 1st February 1964. The main objective of the UTI is to encourage and mobilize the savings of the community and channelize them into productive corporate investment.

Functions of UTI:

1. Mobilizes the saving of the relatively small investors.
2. Channelizes these small savings into productive investments.
3. Distributes the large scale economies among small income groups.

6. Industrial Development Bank of India (IDBI)-1964:

It was established in July 1964. It is the apex bank in the industrial credit, upto 1976 it was the subsidiary bank to RBI but after 1976 it was formed as an autonomous cooperation.

Functions of the IDBI:

1. It can establish the co-operation & co-ordination among the industrial financial institutions.
2. It provides, the direct finance to industrial units.

3. It saves the weaker industrial units through the development assistant fund.

4. It assists in the creation, expansion & modernization of industrial units under private sectors.

5. It also provides the export finance.

7. Export and Import Bank of India (EXIM bank)- 1982:

It was established in 1st March 1982. It is a non-bank financial intermediary (NBFI), confined its area of operations to foreign trade of India. It also performs other functions.

1. Export rediscounting

2. Re-finance supply credit

3. Bulk import finance

4. Foreign currency pre-shipment credit.

5. Product equipment finance programme.

6. Business advisory technical assistance (BATA)

8. National Bank for Agriculture and Rural Development (NABARD)-1982

It was established in July 1982 on the basis of the recommendations' of CRAFI CARD.

1. It is the apex body in the agricultural credit

2. It takes over the functions of agriculture credit department of RBI and Agriculture re-finance development corporation (ARDC).

3. It provides all sources of refinance to the cooperatives, commercial banks and regional rural banks (RRB)

   It also promote the research in agriculture and rural development.

9. Life Insurance Corporation of India (LIC) – 1956

It was established in 1956 by nationalizing 245 private insurance companies. The primary object of nationalization was to protect the interest of the policy holders and avoid the misuse of funds secondly, the object of nationalization was to direct the investments of funds in government security (87.5%), leaving a small part for private sector (12.5%).

10. General Insurance Company (GIC)-1972

It was formed as Government Company in 1972. Before nationalization a few big companies and about 100 small companies were in this business. At present, GIC is provided to 4 companies. They are:

(i) National Insurance Company (NIC)

(ii) New India Assurance Company (NIAC)

(iii) Oriental Fire and General Insurance Company

(iv) United India Fire and General Insurance Company

The main feature of GIC is to sell insurance services against some forms of risk like loss of physical assets of various kinds i.e. The fire accident, and against personal sickness and accidents.

11. Securities and Exchange Board of India (SEBI) – 1988

It was setup in 1988. It got statutory reorganization in 1992. The main purpose of the SEBI is regulating business in stock markets & other securities market.

12. Private Insurance Companies

This millennium has witnessed the insurance sector a journey extending to nearly 200 years. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. According to the recommendation of the committee, huge opening was for the private companies in home and away. Besides the public companies, the others are the private insurers (both life and general) who have done a joint venture with foreign insurance companies to start their insurance businesses in India. Some of the private Life Insurance Companies are Aegon Life Insurance Co. Ltd., Aviva Life Insurance Co. India Ltd., Bajaj Allianz Life Insurance Co. Ltd., and some of the General Insurance Companies are Aditya Birla Health Insurance Co. Ltd., Bajaj Allianz General Insurance Co. Ltd. and Bharti AXA General Insurance Co. Ltd.

13. SWIFT

Behindhand most international money and security transfers are the Society for Worldwide Interbank Financial Telecommunications (SWIFT) system. SWIFT is a huge messaging network banks and other financial institutions use to rapidly, precisely, and securely send and obtain information, such as money transfer instructions. It is a protected financial message carrier which can evade fraudulent transactions. Specifically, it carriages messages from one bank to another bank, say from Bank X reaches Bank Y only.

14. BIS

In the globalized world under the interlinkages between the domestic economies banking and financial operations with the rest of the world, international cooperation in terms of smooth running of the banking and financial system is required. The Bank for International Settlements (BIS) is an international financial institution owned by central banks that “fosters international monetary and financial cooperation and serves as a bank for central banks”. The mission is to support central banks’ pursuit of monetary and financial stability through international cooperation, and to act as a bank for central banks. Currently, sixty central banks or monetary authorities are members of the Bank for International Settlements (BIS). Reserve Bank of India is also a member of the organisation.

15. MUDRA Bank

India’s economic growth largely depends upon the small and medium enterprises. But the banks and the financial institutions are mostly reluctant to provide loans to these sectors in the seamless manner. Micro Units Development and Refinance Agency Bank is a public sector financial institution in India. It delivers loans at low interest rates and simplest terms to the micro-finance institutions and non-banking financial institutions which then provide credit to medium and small enterprises (MSMEs). It was launched by the Honourable Prime Minister of India on 8 April 2015. The minimum age of the applicant must be 18 years and the maximum Mudra Loan age limit is set to 65 years. Loans can be availed by non-farm income-generating businesses in manufacturing, trading and services. The requirement of credit must be ₹ 10 Lakh or lower.

16. Alternative Investment Funds (AIFs)

There is the usual existence of investment funds in India in conventional forms, though there are some alternative funds. Alternative Investment Fund (AIF) is one type of investment fund in India. It is an investment that differs from conventional investments such as debt securities, stocks, etc. It consists of investment funds that are privately pooled and which invest in private equity, venture capital, hedge funds, managed funds, etc.

17. Bad Bank

The history of bank operations in India reveals that there are huge non-refunded funds from the borrowers to the banks which is termed as non-performing assets (NPA) or bad debts or bad loans. The banks could not recover the major part by their own instruments and legal supports. Therefore, the Government of India recommended for an autonomous body to help in recovering these funds. By the term 'bad bank' it is referred to an Asset Reconstruction Company (ARC) or an Asset Management Company (AMC) that takes over the bad loans of commercial banks, manages them and finally recovers the money over a period of time. The bad bank is not involved in lending and taking deposits, but helps commercial banks clean up their balance sheets and resolve bad loans. India's bad bank, National Asset Reconstruction Company (NARCL) will acquire and aggregate the identified NPA accounts from banks and India Debt Resolution Company Ltd (IDRCL) will handle the debt resolution process.

18. Hedge Fund

Hedge fund is a pooled investment fund that trades in relatively liquid assets and is able to make widespread use of more complex trading, portfolio-construction, and risk management methods in an effort to advance performance, such as leverage, short selling, and derivatives. Some samples of hedge funds are Munoth Hedge Fund, Forefront Alternative Investment Trust, Quant First Alternative Investment Trust and IIFL Opportunities Fund, etc.

19. Price-Earnings Ratio

The price-earnings ratio, also known as PE ratio, is the ratio of a company's share price to the company's earnings per share. The ratio is used for valuing companies and to find out whether they are overvalued or undervalued. PE ratios are used by investors and analysts to derive the relative value of a company's shares in an apples-to-apples comparison. It is also used to compare a company against its own historical record or to compare aggregate markets against other companies and/or over time.

20. Venture capital (VC)

It is a type of private equity financing that is provided by venture capital firms or the provisioning of funds to start-ups, early-stage, and emerging companies that are believed to have high growth potential or which have established high growth in terms of annual revenue, number of employees, scale of operations, market power, etc.

21. Asian Development Bank (ADB) – 1966

1. It was established in 1966
2. The main aim for the establishment of ADB is to promote the socio and economic progress of number countries in Asia & Pacific.

3. It is owned by governments of 37 countries form region and 16 countries from outside the region.

4. Its Head Quarters is in Manila, Philippines

5. Poverty reduction is now the main mission of ADB

22. International Monetary Fund (IMF) – 1947

It was established in March 1947. One of the outcomes of Breton Wood Conference was IMF. The main object of IMF is to administer a code of fair practice in the sphere of foreign exchange and to make loans to the economies experiencing temporary deficits in their balance of payments.

Quota:

It is the membership contribution fixed in terms of its national income and internal trade members are required to subscribe quota partly in gold (25%) partly in domestic currency (75%).

Exchange rate:

Members of IMF had to declare the par value of national currency in terms of gold or American dollars. Once the par value of different currencies is fixed it becomes easy to determine the rate of exchange between two countries.

Special Drawing Rights (SDRs) – 1969:

SDR's was first introduced in 1969. It is the special currency issued by IMF. For two reasons IMF created SDR. They are:

1. To overcome the shortage of gold in the world economy

2. To avoid the movement of gold across national boundaries.

SDRs are in Coupons:

It is used in the place of gold. Hence it is called paper gold.

23. World Bank:

It was established in 1947 one of the outcomes of Breton wood conference was establish of World Bank. The main aim of the establishment of World Bank is to help re-construction of the member countries damages due to the Second World War. The original name of World Bank is The International Bank for Reconstruction and Development (IBRD).

24. International Development Association (IDA)

It was established in 1960 and it is affiliated to World Bank. The main aim for the establishment of IDA is to provide assistance to low developed countries (LDC) whose per capita income in less than (dollar) $ 520 (1975). It also grants the credit on cheap terms compared to World Bank loans.

Measures of Credit Control and Money Market

3.4

3.4.1 Credit Creation by Commercial bank

- A commercial bank is called a dealer or creditor.
- It can create credit i.e. can expand the monetary base of a country.
- It does so not by issuing new money but by its loan operations.
- Banks create money on the basis of the cash deposits.
- The process of credit creation is that the depositors think they have so much money with banks and borrowers from bank say they have so much money with them.
- Summing the two, we find an amount more than the cash deposit.
- Suppose a bank receive a sum of ₹ 1,000 as deposit, keeps with it 20% (₹ 200) as CRR (cash reserve ratio) and lends the rest, that is 80% or ₹ 800.
- Depositor will claim he has ₹ 1,000 and bank borrower too possesses ₹ 800.
- Thus total money supply appears to be ₹ 1,800 only. It is the credit creation by a single bank.
- The above example can be extended to cover the banking system as whole. Suppose ₹ 800 is deposited to another bank.
- This bank's base will now expand. It will keep 20% of ₹ 800 (₹ 160) as cash reserve and will lend ₹ 640.
- This sum is redeposited to a third bank which keeps 20% of ₹ 640 (₹ 128) and grants a loan of ₹ 512.
- This process will continue and the mount of fresh deposit will go on falling
- A time will come when deposited sum will be equal to CRR.
- The process will then come to an end.

Limitations of Credit Creation:

Size of the cash reserve ratio:

Much depends on the mix of the cash reserve ratio. Credit creation is inversely related to CRR.

CRR (Cash Reserve Ratio) is a minimum fraction of the total deposits of customers, which commercial banks are required to hold as reserves either in cash or as deposits with the central bank. It is set as per the guidelines of the central bank of the country.

Amount of loan given:

Credit creation depends upon the amount of loan given. If borrowers cannot offer security against loan, bank cannot lend.

Size of the cash deposit:

Size of the cash deposit is also important in this context. The smaller the cash base the smaller scope a bank gets for credit creation. If people prefer physical assets or prefer to keep cash in their hand, bank deposits suffer much, so bank cannot lend much.

Acceptable securities:

A bank can lend money against acceptable securities. A borrower gets a loan from a bank only against some securities the value of which must be equal to the amount of the loan.

Controlled by the Central Bank:

A Central Bank possesses certain instruments. By the use of these it can increase or decrease the volume of credit created by banks.

Credit Control by Central Bank

- A central bank possesses a number of instruments for controlling credit money.
- These are of two types – Quantitative and Qualitative.
- Quantitative techniques seek to regulate total quantity of credit while qualitative measures affect the availability of credit.

Open Market Operations:

- It implies purchase and sale of securities in the stock market.
- When the central bank appears in the market as a seller of government securities, people buy such securities by withdrawing money from banks or the banks themselves invest in such securities instead of granting loan to public.
- In either case the powers of creating credit will be restricted.
- On the other hand, if central bank buys securities money flows out thus enlarging the cash base of members banks.
- Through open market purchase and sale of govt. bonds, the Central Bank can decrease and increase the supply of money. But at the same time the effective rate of interest of the govt. bond gets changed automatically which the Central Bank cannot prevent. Suppose, the govt. bond in question bears a rate of interest 10% with a face value of ₹1000.This implies a yearly return of ₹100. If the Central Bank wants to purchase this govt. bond in unlimited amount for say, ₹ 2000, the effective rate of interest gets changed to 5% automatically which was no part of the intension of the Central Bank.
- Credit expansion depends upon external business environment and borrowers attitudes over which banks have no influence.

Variation of Reserve ratio:

- Commercial banks are legally bound to keep a portion of their deposits in the form of cash reserve.
- It is the most liquid asset in their hand and at the same time it is zero earning assets.

- Naturally, by altering the CRR, the central bank can expand or reduce the funds bank can lend.
- There exists an inverse relation between the size of cash reserve and the amount of credit given by a bank, assuming a given amount of deposit.
- In under developed money market, this technique is more suitable than open market operation or bank rate policy.

Qualitative Credit controls:

- A central bank also possesses certain techniques by which it can control the direction and distribution of credit – purpose wise or areas wise.
- The purpose of selective controls is the rational allocation of scarce bank credit and its economic utilization.
- Further sectorial development of credit and controlling in other directions serve the purpose of preventing speculative activities with the help of bank finance and favoring productive activities.
- These techniques are very helpful in a less-developed economy where overall credit restriction may hinder growth by preventing the flow of credit for investment.

Moral Suasion:

- Moral suasion is a qualitative technique.
- The central bank ‘requests’ banks to lend more or not to lend in some sectors.
- There is no legal compulsion behind their acceptance.
- Generally, if a request is not carried out by the number bank, the guardian of the banking system may take such steps as banks are forced to accept.
- The central bank is often empowered to issue directives to member banks.
- Such direct orders are in the form of directional control, prohibiting loans of particular type of giving advice to grant loan to priority sectors.

3.4.2 Meaning of Money Market

Introduction

Money market is the nerve center of the financial system. A well organized money market is the basis for an effective monetary policy. Money market mobilizes savings from different sources and makes them available for investment. It is the mechanism through which funds flow from surplus units to deficit units in the economy.

Meaning of Money Market:

Financial markets are functionally classified into:

(a) Money market and

(b) Capital market.

This classification is on the basis of the term of credit, i.e., whether the credit is supplied for a short period or long period. Money, market refers to institutional arrangements which deal with short- term funds. Capital market, on the other hand deals in long-terms funds. Money market is a short-term credit market which deals with relatively liquid and quickly marketable assets such as, short-term government securities, treasury bills, bills of exchange, etc.,

Definition:

1. According to Crowther, “The money market is a collective name given to the various firms and institutions that deal with various grades of near- money”.

2. The Reserve Bank of India defines money market “as the center for dealing, mainly of a short-term character, in monetary assets; it meets the short-term requirements of borrowers and provides liquidity of cash to the lenders.

Objectives of Money Market:

A well-developed money market serves the following objectives:

(i) Provides an equilibrium mechanism for ironing out short-term surplus and deficits.

(ii) Provides a focal point for the intervention of the central bank for influencing liquidity in the economy.

(iii) Provides access to user of short term money to meet their requirements at a reasonable price.

Characteristics of Money Marketing:

Indian money market has major features:

1. Short-term funds are borrowed and lent.

2. No fixed place for conduct of operations. Transactions are conducted even over the phone.

3. Dealing may be conducted with or without the help of brokers.

4. The short-term financial assets that are dealt in are close substitutes for money.

5. Funds are loaned for a maximum period of 1 year.

6. Presence of a large number of sub-markets.

Structure and Functions of Indian Money Market

Functions of Money Market:

1. It links lenders and borrowers of short-term funds. It is purely a market for short term funds or financial assets.

2. It provides working capital requirements of industry, trade and agriculture.

3. It provides financial assets with a high degree of liquidity- call money, treasury bills, commercial bills etc.

4. It helps trade and commerce by developing a bill market, and acceptance market.

5. It enables the Government to raise short-term loans with Treasury bill market.

6. It is controlled and regulated by RBI.

7. It makes the monetary policy effective.

8. It provides opportunities for lending the surplus funds of individuals, banks and other institutions.

9. It helps the central bank in maintaining stability of the value of the currency unit.

A well developed money market can perform the above functions effectively.

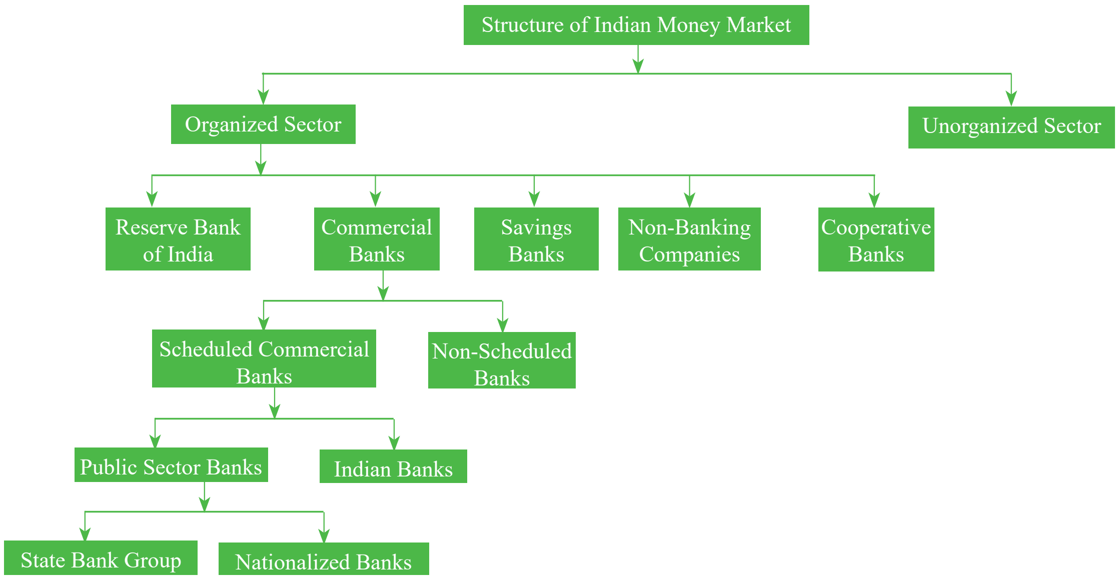


Figure-3.1 Strucure of Indian money market

Organized Sector:

It is called organized because its activities are systematically coordinated by the RBI. The players in the organized sector are as follows:

(i) The organized modern sector of Indian money market comprises: (a) the Reserve Bank of India; (b) The State Bank of India and its associate banks; (c) the Indian joint stock commercial banks (Scheduled and non-scheduled) of which 27 scheduled banks have been nationalized (d) the exchange banks which mainly finance Indian foreign trade; (e) cooperative bank; (f) other special institutions, such as, Industrial Development Bank of India, State Finance Corporations, National Bank for Agriculture and Rural Development, Export-Import Bank, etc., which operate in the money market indirectly through banks; and

(ii) Non-bank financial institutions such as the LIC, the GIC and subsidiaries, the UTI operate in this market, but only indirectly through banks, and not directly.

(iii) Quasi-Government bodies and large companies also market their short-term surplus funds available to the organized market through banks.

(iv) Cooperative credit institutions occupy the intermediary position between organized and unorganized parts of the Indian money market. These institutions have a three tire structure. At the top, there are State cooperative banks, At the local level, there are primary credit societies and urban cooperative banks, Considering the size, methods of operations, and dealings with RBI and commercial banks, only state and Central cooperative banks should be included in the organized sector, The cooperative societies at the local level are only loosely linked with it.

Unorganized Sector:

The unorganized sector consists of indigenous banks and money lenders. It is unorganized because activities of its parts are not systematically coordinated by the RBI. The money lenders operate throughout the country, but without any link among themselves indigenous banks are somewhat better organized because they enjoy rediscount facilities from the commercial banks which, in turn, have link with the RBI. But this type of organization represents only a loose link with the RBI.

Constituents of Money Market: Lenders & Borrowers

Money market is a center where short-term funds are supplied and demanded. Thus, the main constituents of money market are the lenders who supply and the borrowers who demand short-term credit.

1. **Supply of Funds:**

   There are two main sources of supply of short-term ‘funds in the Indian money market: (a) unorganized indigenous sector, and (b) organized modern sector.

2. **Demand for Funds:**

   In the Indian money market, the main borrowers of short-term funds are : (a) Central Government, (b) State Government, (c) Local bodies, such as municipalities, village panchayats, etc., (d) traders, industrialists, farmers, exporters and importers, and (e) general public.

III. Sub- Markets of Organized Money Markets:

The organized sector of Indian money market can be further classified into the following sub-markets. It has the following money market instruments:

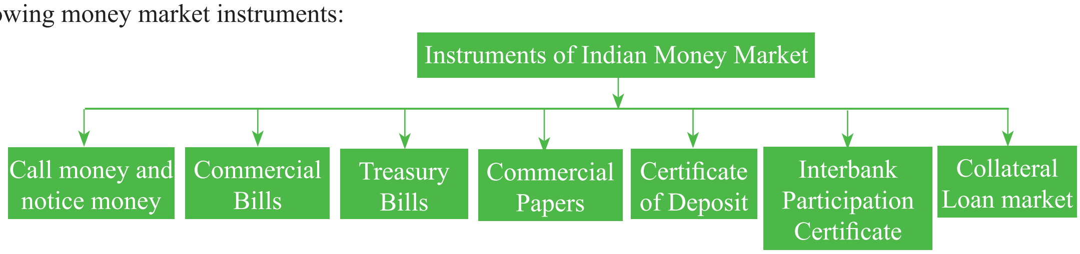


Figure-3.2 Instruments of Indian money market

1. **Call and Notice Money Market:**

   The call and Notice Market constitutes the core of the Indian Money Market. Call money represents the amount borrowed by commercial banks from each other for short periods to meet their cash reserve requirements, Those banks whose cash reserves decline below the statutory requirement borrow from such banks which have surplus cash reserves, Funds are thus borrowed and lend for one day (call) and for a period up to 14 days (notice) without any collateral security. The market has thus two segments- (I) call or overnight market and (ii) short notice market. The rate at which funds are borrowed and lend in this market is called call money rate. The rate is determined by demand and supply.

2. **Commercial Bill Market:**

   These are Bills of exchange dawn by the seller (drawer) on the buyer (drawee and acceptor) for the value of goods sold. Once the bill is accepted by the buyer of goods (drawee), it becomes a legal document acknowledging indebtedness. It is a negotiable instrument. Such bills are drawn generally for 90 days. During the tenure of the bill, if the holder is in need of cash he can discount it with a commercial bank. The bank will deduct interest (called a negotiated discount rate) for the period the bill is yet to run. The bank will receive the face value on the due date from the drawee. Meanwhile, if the bank is in need of funds, it can rediscount it in the commercial bill rediscount market at the market-related discount rate. Banks arrange their bill portfolio in such a manner that some bills mature every day. These trade bills (commercial bills) are considered liquid assets as they can be converted in to cash quickly by rediscounting.

3. Treasury Bills Market:

Treasury bills are short-term promissory notes issued by the G.O.I at discount generally for a period of 91 days. They are issued to meet short-term financial needs of the Government. Since November 1986, 182 days Treasury Bills were issued by the R.B.I. Longer maturity Treasury Bills with varying maturities upto 364 days were introduced in April 1992. These bills were issued as a part of public debt operations of G.O.I. They are issued at discount and therefore do not carry interest payment obligation.

4. Commercial Paper:

On the recommendations of Vaghul Working Group, commercial paper is introduced in the Indian money market in January 1990. The need for the introduction of this instrument has arisen out of the changing industrial scenario. In the environment created by Liberalization policies of the Government, the industrial sector launched plans of diversification, expansion and modernization of their units. This has lead to an enhanced demand for funds and to satisfy the demand C.P is introduced. Commercial papers are unsecured promissory notes issued by corporate entities to raise resources for their short-term needs instead of borrowing from banks. It is a certificate evidencing an unsecured corporate debt of short maturity. It represents a promise by the borrowing company to repay loan at a specified date.

5. Certificate of Deposit:

The RBI introduced the Certificates of Deposits Scheme in June 1989. The object is to further widen the range of money market instruments and to give investors further opportunity of deploy their short-term funds. C.D's are deposit receipts issued by banks against deposits kept by individuals, companies, P.S.Us and other institutions. Non-resident Indian can also subscribe to C.Ds but only on a non-repatriation basis.

6. Inter-bank Term Money Market:

This is a market in which banks alone, both commercial and co-operative banks participate. They borrow and lend funds from and to each other for a period over 14 days and generally upto 90 days. No collateral security is insisted upon. The rates of interest are market determined. Deposited receipts are exchanged. As per the Indian Banks Association (I.B.A) rules, lenders cannot prematurely call back these loans. Hence, this instrument is not liquid.

7. Collateral Loan Market:

It deals in collateral loans- These loans backed up by security. In this market, commercial banks provide loans against the Government securities and bonds.

Defects of Indian Money Market

The Indian money market is inadequately developed, loosely organized and suffers from many weaknesses. Major defects are discussed below:-

1. Dichotomy between Organized and Unorganized Sectors:

The most important defect of the Indian money market is its division into two sectors: (a) the organized sector and (b) the unorganized sector. There is little contract, coordination and cooperation between the two sectors. In such conditions, it is difficult for the Reserve Bank to ensure uniform and effective implementations of its monetary policy in both the sectors.

2. **Predominance of Unorganized Sector:**

   Another important defect of the Indian money market is its predominance of unorganized sector. These indigenous bankers, which constitute a large portion of the money market, remain outside the organized sector. Therefore, they seriously restrict the Reserve Bank's control over the money market.

3. **Wasteful Competition:**

   Wasteful competition exists not only between the organized and unorganized sectors, but also among the members of the two sectors. The relation between various segments of the money market is not cordial; they are loosely connected with each other and generally follow separatist tendencies. Similarly, competition exists between the Indian commercial banks and foreign banks.

4. **Absence of All- Indian Money Market:**

   Indian money market has not been organized in to a single integrated all-Indian market. It is divided into small segments mostly catering to the local financial needs. For examples, there is little contract between the money market in the bigger cities. Like, Mumbai, Chennai, and Kolkata and those in smaller towns.

5. **Inadequate Banking Facilities:**

   Indian money market is inadequate to meet the financial needs of the economy. Although there has been rapid expansion of bank branches in recent years particularly after the nationalization of banks, yet vast rural areas still exist without banking facilities. As compared to the size and population of the country, the banking institutions are not enough.

6. **Shortage of capital:**

   Indian money market generally suffers from the shortage of capital funds. The availability of capital in the money market is insufficient to meet the needs of industry and trade in the county.

7. **Seasonal Shortage of Funds:**

   A major drawback of the Indian money market is the seasonal stringency of credit and higher interest rates during a part of the year. On the contrary, during the slack season, from July to October, the demand for credit and the rate of interest decline sharply.

8. **Diversity of Interest Rates:**

   Another defect of Indian money market is the multiplicity and disparity of interest rates. The interest rates also differ in various centers like Mumbai, Kolkata etc. Variations in the interest rate structure are largely due to the credit immobility because of inadequate, costly and time-consuming means of transferring money. Disparities in the interest rates adversely affect the smooth and effective functioning of the money market.

9. **Absence of Bill Market:**

   The existence of a well- organized bill market is essential for the proper and efficient working of money market. Unfortunately, in spite of the serious efforts made by the Reserve Bank of India, the bill market in India has not yet been fully developed. The short-term bills form a much smaller proportion of the banking finance in India as compared to that in the advanced countries.

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 an 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.

Exercise

Theoretical Questions

I. Multiple Choice Question (MCQ)

1. Which of the following is near money?

   (a) Bill of exchange

   (b) Saving bonds

   (c) Gilt edged securities

   (d) All the three

2. Optional money is a:

   (a) Legal tender money

   (b) Non-legal tender money

   (c) Limited legal tender money

   (d) Full bodied money

3. Which of the following function does money serve when used to measure the prices of different goods and services?

   (a) Store of value

   (b) Medium of exchange

   (c) Standard of value

   (d) Display of power

4. Which of these affects the demand for money?

   (a) Real income

   (b) Price level

   (c) Rate of interest

   (d) Both (a) and (c)

5. 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

6. Supply of money refers to

   (a) Total money held by the public

   (b) Total money held by RBI

   (c) Total money with all the commercial banks and RBI

   (d) Total money in Government account

7. Which is the apex bank for agricultural credit in India?

   (a) RBI

   (b) SIDBI

   (c) NABARD

   (d) IDBI

8. RBI check inflation by

   (a) Increasing bank rate

   (b) Increasing CRR

   (c) Both

   (d) None

9. If the country is passing through recession, the RBI would

   (a) Buy bonds

   (b) Reduce CRR

   (c) Ease out bank rate

   (d) All or any of the above three

10. Manipulation in CRR enables the RBI to …….

    (a) Influence the lending ability of the commercial banks

    (b) Check unemployment growth

    (c) Check poverty

    (d) Increase GDP

11. EXIM Bank is authorized to raise loan from

    (a) RBI

    (b) Government of India

    (c) International market

    (d) Trading activities

12. RBI was nationalized in

    (a) June 1947

    (b) Jan. 1949

    (c) March 1954

    (d) April 1936

13. FERA has been replaced by

    (a) FINA

    (b) FEMA

(c) FENA

(d) MRTP

14. Repo transaction means

(a) Sale of securities by the bolder to the investor with the agreement to purchase them at a predetermined rate and date.

(b) Sale of securities by the holder to the investor with the agreement to resell them at a predetermined rate and date.

(c) Sale and purchase of securities by the holder to the investor with the agreement to purchase them at the prevailing rate and date

(d) Sale of securities by the holder to the investor with the agreement to purchase them at market driven rate.

15. Reverse Repo transaction means

(a) Sale of securities by the holder to the investor with the agreement to purchase them at a predetermined rate and date

(b) Sale or purchase of securities by the holder to the investor with the commitment to sell or purchase them at a predetermined rate and date

(c) Sale and purchase of securities by the holder to the investor with the agreement to purchase them at the prevailing rate and date

(d) Sale of securities by the holder to the investor with the agreement to purchase them at market driven rate

16. Given a reserve ratio of 20% in initial deposit of ₹1000 in a banking system would create secondary deposit of ₹…………..

(a) ₹ 3,000

(b) ₹ 5,000

(c) ₹ 4,000

(d) ₹ 6,000

17. Money market deals with the ………

(a) Short term credit

(b) Long term credit

(c) both A & B

(d) None

18. Money market includes ………

(a) Government securities

(b) treasury bill

(c) bills of exchange

(d) All the above

19. In Indian money market, who are the main borrowers of short term funds

    (a) central government

    (b) State government

    (c) local bodies

    (d) All the above

20. Money market is controlled by …..

    (a) Government

    (b) R.B.I

    (c) S.B.I

    (d) all the above

21. In April 1999 the government of India introduced the bills for the period of …..

    (a) 91 days

    (b) 182 days

    (c) 364 days

    (d) None

22. In call money market funds are borrowed of rent without any security for the period of…

    (a) one day

    (b) 14 days

    (c) a & b

    (d) NONE

23. If buyer of the goods is called ……

    (a) Drawer

    (b) drawee

    (c) payee

    (d) none

24. Certificate of deposits are issued by the banks to …..

    (a) individual

    (b) companies

    (c) P.S.U.S

    (d) All the above

25. Which are unsecured promissory notes
    (a) Commercial paper
    (b) Certificate of deposits
    (c) Treasury bills
    (d) all the above
26. Commercial banks provide collateral loans against …..
    (a) bonds
    (b) govt. security
    (c) both A & B
    (d) None

II. State True (or) False

1. According to Walker, money is what money does
2. Money is treated as means of trade and commerce
3. Examples of NBFI are cash money and credit money
4. According to Cambridge equation if 'K' is more the value of money should increase
5. According to Keynes the rate of interest cannot decide the value of money
6. There is a direct relationship between price level and value of money
7. During the inflation period borrowers will gain
8. Public expenditure come under the monetary policy
9. Tax policy come under Fiscal policy
10. M_1 is considered as the most important measure of money
11. Bank is said to be dealer in debt
12. Bank impose a limit on the amount and number of withdrawals on saving bank a/c
13. Fixed deposits are followed by business people
14. Over draft facility is given to small income people
15. Banks keep the wills of their customers and execute them after their death
16. CRR cannot control the credit creation
17. RBI issues the one rupee notes and coming
18. Moral suasion is a qualitative technique
19. Profit is the main motto of central Bank
20. IMF secure the stability of foreign exchange rate
21. MUDRA Bank focuses on large borrowers
22. Price-earnings ratio is the ratio of a company's share price to the company's earnings per share

23. Hedge fund trades in relatively liquid assets
24. Venture capital firms make the provisioning of funds to start-ups
25. The instrument commercial paper has risen out of the changing industrial scenario
26. R.B.I introduced the certificates of deposits in June 1998
27. Collateral loans are given by commercial banks without security
28. In Indian money market there is a multiplicity and disparity of interest rates
29. The short term bills form a much smaller proportion of the bank finance in India as compared to advanced countries

III. Fill in the blanks

1. Money means any things that passes ____________
2. Bonds, Government securities refer to _________ money.
3. ______ Market is also called the credit market.
4. If someone keeps some money for bad days, the demand for money is known by _____ motive of money.
5. _____ function of money leads to saving and investment.
6. The inverse value of price is called _______.
7. According to Fisher's theory of money is demanded for _______ purpose.
8. Broad money is usually the sum of __________ and ___________.
9. SIDBI is a subsidiary bank of __________________
10. _____________ is the apex bank in banking system.
11. The tow primary functions of a bank are deposit function and ______ function.
12. Credit creation is the function of _______ bank.
13. A bank must keep _____ cash in hand to meet the closing of depositors.
14. Central bank enjoys the exclusive power of _____ issue
15. If the bank rate increases, the demand for bank loan _____
16. ICICI is a ____________ sector bank
17. ARDC was merged in ________ bank
18. IDA is affiliated to _____bank
19. Financial market are classified into money market and capital market on the basis of ____
20. The short term financial assets that are dealt in are __________ for money
21. ________ provide working capital requirement s of industry, trade and agriculture.
22. Call money represent the amount borrowed by _______ from each other for the short term requirement.
23. Generally commercial bills are prepared for the period of _____ days.

IV. (a) Match the following

1.	Liquidity preference	(A)	public debt
2.	M_3	(B)	loss of barrowers
3.	M_2	(C)	credit money
4.	Fiscal policy	(D)	Highest moniners
5.	Deflation	(E)	m_2 + time deposit
6.	Demand deposit	(F)	Bimetalism
7.	Commercial banks	(G)	Keynes
8.	Near money	(H)	Cheque
9.	Gresham's law	(I)	m_1+ post office saving

(b) Match the following

1.	Commercial Bank	(A)	Lender of last resort
2.	Credit creation	(B)	Exim bank
3.	Central Bank	(C)	1982
4.	UTI	(D)	manila
5.	Foreign trade	(E)	ARDC
6.	ADB	(F)	1969
7.	SDR	(G)	commercial bank
8.	LIC	(H)	1956
9.	NABARD	(I)	Discounting bills
10.	EXIM Bank	(J)	Small investment

(c) Match the following

	Column A		**Column B**
1.	Corporate bank	(A)	Money market
2.	Commercial paper	(B)	R.B.I
3.	Seller	(C)	Local bodies
4.	Demand for money market	(D)	Organized sector
5.	Monetary policy	(E)	Drawer.

V. Short Essay Type Questions (Give the answer in one or two sentences)

1. Explain the 'Gresham's law".
2. What do you mean by Liquidity preference?
3. Define the Repo Rate.
4. What is Deflation?
5. What is Stagflation?
6. What do you mean by Internal value of money?
7. What do you mean by External value of money?
8. What is Semi inflation?
9. What is Open inflation?
10. Define Deficit finance.
11. Explain the term Monetary policy.
12. Explain the term Fiscal policy.
13. Give short notes on the following topics.
    a. ICICI
    b. SIDC
    c. L.I.C
    d. G.I.C
    e. World bank
14. Explain the term SDR.
15. Explain the term Quota.
16. What is Over draft.
17. Discuss about Commercial bill market.
18. Discuss about Call money market.
19. What is Treasury bills?
20. What is Commercial paper?
21. What is Certificate of Deposit?

VI. Essay Type Questions

1. What are the difficulties of barter system?
2. Define money and explain the function of money.
3. Explain the forms of money.

4. Explain Fisher' Quantity Theory of Money.
5. Explain cash balance approach to the Quantity Theory of Money.
6. Discuss about quantity theory of Money.
7. What are the components of money supply (or) monetary aggregates?
8. Write a note on different types of money.
9. What is commercial Bank? And explain the functions of commercial banks?
10. What are the principles of commercial banks?
11. What are essential conditions of sound banking system?
12. What is meant by credit creation? State the limitations of credit creation?
13. What are the functions of central bank?
14. What are the instruments used by RBI to control the credit creation?
15. Distinction between Central Bank and commercial banks?
16. Discuss about IFCI (expansion)
17. Discuss about IDBI
18. Discuss about SFC
19. Discuss about EXIM Bank
20. Discuss about NABARD
21. Explain the functions of ADB
22. Discuss about IMF
23. Discuss about SEBI
24. Write a note on MUDRA Bank.
25. Discuss the importance of private insurance companies in India.
26. Write notes on SWIFT, Bad Bank and BIS.
27. Define money market and state the objectives of money market.
28. Define money market and state the capitalistic of money market.
29. What is money market and explain the functions of money market?
30 Explain the structure of money market.
31. What are the constitutes of money market?
32 What are instruments of Indian money market?
33. Explain the defects of Indian money market.
34. Explain the measures to improve the Indian money market.

Answer:

I. Multiple Choice Question (MCQ)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
d	b	b	d	c	a	c	c	d	a	b	d	b	a	d	c	a	d	d	b
21	22	23	24	25	26														
c	c	b	d	a	c														

II. State True or False

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
T	T	F	T	F	F	T	F	T	T	T	T	F	F	T	F	F	F	F	T
21	22	23	24	25	26	27	28	29											
F	T	T	T	T	F	F	T	T											

Fill in the blanks:

1	General acceptability	2	near
3	money	4	precautionary
5	standard of deferred payment	6	value of money
7	transaction	8	M1 & M2
9	IDBI	10	RBI
11	Loan	12	Commerical
13	idle	14	note
15	decrease	16	private
17	NABARD	18	World
19	Term of Credit	20	Close substitute
21	money market	22	Commercial Banks
23	90		

IV. Match the following

(a)

1	2	3	4	5	6	7	8	9
H	F	I	A	B	D	C	E	G

(b)

1	2	3	4	5	6	7	8	9	10
I	G	A	J	B	D	F	H	E	C

(c)

1	2	3	4	5
D	A	E	C	B

ECONOMIC AND BUSINESS ENVIRONMENT 4

This Module includes

ECONOMIC AND BUSINESS ENVIRONMENT

Module Learning Objectives:

After studying this Module, the students will be able to –

- Appreciate the various elements (Political, Economic, Societal, Technological Environmental and Legal) of an all-round analyses of business environment.
- Develop a detail understanding of risks and challenges that emanate from dynamic business environment characterized by Volatility, Uncertainty, Complexity, Ambiguity, Fear of Unknown and Unprecedentedness (VUCAFU).

PESTEL (Political, Economic, Societal, Technological, Environmental and Legal) Analysis

4.1

4.1.1 Meaning of Economic and Business Environment

Business organization operates under its own unique environment. Environment always influence the business and vice-versa. So, business cannot ignore environmental impacts. In modern economy, the nature and techniques of business are rapidly changing along with the change in environment. With the revolution in the Information Technology (IT) sector, the pattern of business has undergone a sea-change. The concept of e-commerce, e-bay were non-existent in the past. Extensive use of internet in business has reduced the entire world into a single village and the physical boundaries between nations have vanished in thin air. Recently, the worldwide attack of Corona virus has further changed the pattern of business. Contactless business has made us more dependent on internet. Covid-19 (the disease from corona virus) pandemic has opened up new avenues of business particularly in the education and health sector. The mushroom growth of tutorials for online classes and pathological covid-test/ vaccination centres are some of the glaring examples of such endeavours.

4.1.2 Business

The term business means any activity comprising of manufacturing/producing of products and/or services, purchase of raw materials and marketing the finished goods in order to earn profits. Profit is the difference between total revenue and total cost. Profit is the reward or remuneration for risk taking and organizing the production and sales process, just like the worker earns wages. Profit is the impetus for the entrepreneur who runs the business. Business efficiency can be achieved through maximization of profit. Therefore, profit can be treated as a measure of business performance. So, business efficiency can be gauged through percentage of profit to sales volume, or to capital employed, or to the market value of corporate shares etc.

4.1.3 Objectives of Business

The purpose of business is to create market with the aim of expanding it. In a broader sense, the purpose of business is to cater to the material needs of the society. Through business the society can have economic expansion, growth and development. The multiple objectives of business are related to profitability, sales maximization, productive efficiency, stability and growth, technological excellence, self- reliance, survival, competitive strength, customer satisfaction, financial solvency, product quality, diversification, welfare of the employees etc.

4.1.4 Business Environment and its Influence on Business

The environment in which an enterprise functions could be divided into two parts – external and internal environment. The internal environment includes factors which are under the control of the firm, like the business philosophy, business priorities, management structure, capital structure, etc. External environment, on the other hand , includes factors which are beyond the control of the firm, like economic factors, legal factors, demographic factors, geographic factors, Government regulations, etc. The external environment includes such factors outside the organization which provide opportunity or pose threats to the organization. The internal environment includes all such factors within an organization which give strengths or cause weaknesses of a strategic nature.

An opportunity is a favourable condition in the external environment which helps the firm to consolidate and have a sound footing in the market. An example of an opportunity is a sudden growing demand for the products that the firm produces.

A threat is an unfavourable condition in the external environment which creates a risk for the firm that leads to huge loss. Example for such a threat is the emergence of strong new competitors who are likely to encroach most of the markets of the firm.

A strength is the positive aspect of the internal environment which the firm can use to gain strategic advantage over its competitors. Example of strength is setting up of R and D department by the firm which can be used to develop new products so that the firm gains an edge over the competitors.

A weakness is the negative aspect of the internal environment which causes a strategic disadvantage for the firm. Example of weakness is the failure of the firm to adopt diversification in the product line. Single product may lead to a crisis if the market fails.

Business firms pursue SWOT analysis to understand the external and internal environment. SWOT is the acronym for strength, weakness, opportunity and threat. Through such an analysis, an effective organizational strategy can be formulated which capitalizes on the opportunities by using strengths and neutralizes the threats by minimizing the impact of weaknesses. This SWOT analysis is important for indicating the competitive strength and viability of any business firm.

4.1.5 External Business Environment

The external factors in the business world which are beyond the control of any particular business firm, determine the external business environment. This external business environment can be classified into two – micro environment and macro environment.

4.1.6 Micro Business Environment

The activities of customers, suppliers, competitors, marketing agencies, etc.in the immediate neighbourhood of a business firm create the micro business environment of that firm. The micro environment of any particular firm may be different from that faced by the other firm within the same industry. For example, if the supply sources are different in case of two different business firms, their micro environment would also be somewhat different. This micro business environment influences the strategic decisions by creating different business opportunities as well as threats.

4.1.7 Components of Micro Business Environment

The principal components of micro business environment of any business firm are as follows:

(1) **Suppliers:** Suppliers form an important component of the micro environment. The suppliers provide raw materials, equipment, services and so on. Suppliers with their bargaining power affect the cost structure of the industry. They constitute a major force that shapes competition in the industry. Firms have to take strategic decision on "outsourcing" or "in-house" production depending on this supplier environment.

(2) **Consumers/Customers:** The aim of business is to create and retain market, or in other words, to create and retain customers.A firm cannot exist without customers. The prerequisite for a success in business is customer's satisfaction. There may be different categories of customers of a firm, viz., individuals, households, corporate houses, the Govt. etc. For example, Indian oil corporation has got customers which include individuals, households, other business firms, state transport corporations, Air India, foreign airlines etc. The bargainingpower of all these customers and their changing preference pattern influence the business decisions of producer firms.

(3) **Competitors:** Competitors are the other firms that compete for resources and for markets. Competition shapes business. A study of the competitive scenario is essential for a firm to take strategic decisions, particularly in view of the threat perspective of competition.Competition may be direct, for example, there is 'brand competition' where similar products of different "brand names" compete with one another for increasing their market-shares. Sony colour TV competes with Panasonic colour TV and Phillips colour TV. Competition among firms who produce and sell similar types of consumer durables (such as TV, stereo, tape recorders etc.) is called "generic competition". Again, competition can also be indirect. For example, competition between a holiday resort and car manufacturing company for available discretionary income of affluent customers is indirect competition.

(4) **Marketing intermediaries:** Marketing intermediaries bridge the gap between producers and final consumers. These marketing intermediaries include commission agents, transport companies and warehouses, advertising agencies,marketing research firms, media firms, financial intermediaries etc.In a competitive business world, these intermediaries play a crucial role in expanding the market of any product not only in the domestic market but also abroad. With the advancement of information technology, the scope of the activities of these intermediaries has also expanded to a great extent. For example, the media firms help business enterprises in creating and maintaining their websites so that a huge number of prospective buyers all over the world can get acquainted with the product.

(5) **Market:** The market is a wider term than vendors and customer. The market is to be studied in terms of its cost structure, its price sensitivity, its growth prospect and its attractiveness. The firm should study the trends and development and the key success factors of the market. The dynamic business strategy of the firm will depend on the nature of the market – such as competitive, monopolistic, monopolistic competition, discriminating monopolistic, oligopolistic etc.

(6) **Organization**:Individuals working in different capacities in the organization are the pillars of the firm which form the strength and capabilities in the particular business. So employees arethe major force within an organization. It is important for an organization that employees embrace the same values and goals as the organization. Board of directors should run the organization in a way that best serves the share holders' interests. Finally the entrepreneur should be dynamic and risk taker so that profit of the firm can reach the bliss level.

4.1.8 Macro Business Environment

Macro business environment is entirely external to the firm and thus beyond the direct influence and control of the organization, but which exerts powerful influence over its functioning. The principal components of the macro business environment are the economic environment, political and regulatory environment, socio-cultural environment, demographic environment, technological environment and natural environment. The success of the business firm depends to a large extent on its adaptability to these dynamic forces of macro business environment. The business opportunities and threats to any business firm depend to a large extent on those forces of themacro business environment. By analyzing the macro business environment, a firm can formulate its strategic policies to grab the opportunities and can take firm decisions to stay away from the threats.

4.1.9 Components of Macro Business Environment

The following are the components of macro business environment:

(1) **Demographic Environment:** Business is heavily dependent on population's size, age structure, geographic distribution, ethnic make-up and distribution of income. Demographic characteristics and its change has far reaching implications on the future competitiveness of the company and also on the formulation of its strategic policy.

(2) Economic Environment: The economic environment refers to the nature and direction of the economy in which the company operates. On the one hand, economic environment includes situation in resource markets like, money market, labour market, raw material availability, services and supply markets, which influence the supply of inputs to the enterprise, their costs, quality, availability and reliability of supplies. On the other hand, economic environment determines the strength and size of the market. The purchasing power in an economy depends on current income, prices, savings, circulation of money, debt and credit availability. Income distribution pattern and the propensity to consume together determine the marketing possibilities. Economic prospect of the country and its inflation rate has far reaching impact on the operations of the firm.

(3) Political-Legal Environment: Business is controlled by Govt. policies viz., fiscal, monetary, industrial, labour and export-import policies etc. a business strategist follows the changes in the regulatory framework and their impact on business.

Firms prefer to operate in a country where there is a sound legal system. Firms must be conversant with the relevant laws relating to company, consumer protection, competition, intellectual property, foreign exchange, labour etc.

Political pressure groups influence the decision making process of the organization by encroaching into the trade union activities. Apart from this, the political pressure groups tries to protect the consumer's rights, women rights and minority rights by putting pressure on the enterprise.In India, rivalries within political parties, lack of political consciousness among a huge number of illiterate and poverty-stricken people, influence of ex-zaminders and business-groups in the leadership of political parties etc., stand in the way of making an efficient and strong Government. Also lack of political stability creates uncertainty in business environment

(4) Socio-Cultural Environment: Socio-cultural environment comprises of social traditions, values and beliefs, level and standards of literacy and education, the ethical standards and state of society, the extent of social stratification, conflict and cohesiveness and so forth. The core beliefs of a particular society tend to be persistent. It is difficult for businesses to change these core values, which becomes a determinant of its functioning. For example, the old caste system in India is supposed to be one of the important reasons behind the lack of labour mobility. Another social institution in India like the joint family system also created a class of lazy and dependent people and restricted the entrepreneurship and savings propensity of individuals.

Culture is the sum total of societal behaviour. It includes three basic elements, viz., (a) knowledge and beliefs, (b) ideals, and (c) preferences. The cultural characteristics of any society are very important in determining business strategies. For example, Nestle co. brews a variety of instant coffee to satisfy different taste patterns in different countries.

(5) Technological Environment: The level of technological development, type of technology in use, the speed with which newly invented technologies are adopted and diffused, the R & D activities for the innovation of new technologies etc., determine the technological environment of any economy.

With the introduction of "Green Revolution" in Indian agriculture, India could create a wide domestic market for modern agricultural implements like power tillers, tractors, pump sets, threshers, bulldozers etc. On the other hand, with the increase in the generation and distribution of electricity, the demand for various electrical home appliances has increased in India.

Technology can bring opportunity or pose a threat to the business. When organizations adopt technological innovations quickly and set the business strategy, it will act as an advantage. But if they fail to adopt innovations to their advantage, it will be a threat.

With the revolution of "Information Technology", extensive use of internet has enabled a huge number of employees to work from home and provided strategists with access to richer sources of information through

"Google search machine". It has also provided customers with access to online shopping through internet.

(6) Global Environment:

Today's dynamic competitive landscape of the business world requires that companies must analyse global environment as it is rapidly changing. The new concept of global village has changed how individuals and organizations relate to each other. New migratory habits of the work force and increased offshore operation are changing the dynamics of business operation.

For developing countries like India, "Globalization" means integration with the world economy. This integration process turns the world into one huge market. Such unification calls for removal of all trade barriers among countries.

In the early years of Indian planning (1951-79) different economic policies tried to protect Indian industries from foreign competition, producing import substitutes. Public sector enterprises were subjected to various restrictions and control measures.

Since early 1990s, the Govt. of India has been following liberal policies through drastic reduction in Govt. control over various economic activities. Under this changed environment, private sector enterprises can flourish and can expand in various sectors in India.

The foreign investors and multinational companies(MNCs) can also enter easily in different sectors without much trouble. The Govt. has been following the principle of decontrol and delicensing to encourage private sector enterprises, which resulted to the replacement of MRTP Act (1969) by the Competition Act (2002). Some new acts have also been passed to allow the entry of private sector enterprises in the insurance and IT sectors.

Since the inception of World trade organization (WTO) in 1995, several countries of the world along with India were the members of WTO, which is a multilateral trade arrangement. As per the provisions of WTO, India was forced to amend Indian Patent Act (1970) to safeguard the "Trade related Intellectual Property Rights". So India had to move from process patent to product patent regime. For example, in the pharmaceutical sector, only the process of manufacturing a drug was protected under the Indian Patent Act (1970). But according to WTO provisions, patent will be granted for a period of 20 years for any product invented. So, the MNCs in the pharmaceutical sector which invest huge sum of money in R & D to develop new medicine would be benefited.

However, the policy of globalization make the Indian business firms vulnerable to business fluctuations in the world economy. If the world suffers from global depression, or if the stock market crashes in US and Europe, this will affect the business economy in India also.

A final corollary to globalization is the formation of trade blocks. Countries, like corporations, form strategic alliances to ward off economic and technological threats and retain their respective comparative and competitive advantages. NAFTA (North American Free Trade Area), European Union (EU), South Asian Association for Regional Cooperation (SAARC) are some of the examples in this regard.

(7) Covid 19 Pandemic riddled Environment:

The end of the year 2019 witnessed an unprecedented global attack of Novel Corona virus which caused a disease called Covid 19. Lakhs of people died all over the world. The disease is so contagious that it was spreading like wild fire in all the countries of the world. As a result most of the Governments in different countries were forced to lock down to contain the spread of the disease. The growth rate of most of the economies became close to zero as all economic activities screeched to a halt. All organizations asked their employees to work from home. Schools, colleges were shut down. Teachers started online classes. Customers preferred online shopping as going to the market was risky. The whole world became very much dependent on the internet. The IT based industries flourished while manufacturing industries found it difficult tomaintain the production level. In early 2022 the whole world is reeling under the third wave of the pandemic and nobody knows how many waves of the pandemic is yet to come. In this period of complete uncertainty one thing is certain that all IT based business will develop.

4.1.10 PESTEL Analysis

PESTEL is a term coined to describe a framework or tool used by marketers to analyze and monitor the macro-environmental factors that have an impact on an organization, company or industry. It examines the political, economic, social, technological, environmental and legal factors in the external environment. Pestel analysis helps an organization to formulate its strategic policy. This tool is especially useful when starting a business or entering a foreign market. It is often used in collaboration with other analytical business tools such as the SWOT analysis and Porter's Five Forces. A PESTEL analysis is used to identify threats and weaknesses which are used in a SWOT analysis. Change in the business environment, just like any other change we experience, can either bring positive returns like creating opportunities or can cause significant threats affecting the smooth functioning of the organization. Porter's Five Forces Model is a competitive analysis based on competitive pressures from five sources (a) rival sellers (b) new entrants (c) substitute products (d) bargaining power of suppliers of inputs (e) bargaining power of buyers. The strategists of the organization have to determine whether the collective strength of the five competitive forces is conducive to earning attractive profits.

4.1.11 Factors Included in Pestel Analysis

PESTEL is an acronym for:

P - political

E - economic

S – socio-cultural

T – technological

E – environmental

L – legal

The PESTEL analysis is simple to understand and quick to implement. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

Political factors:

These factors are all about how and to what degree a government intervenes in the economy or a certain industry. It is the part of good governance. The nature of government influences may be channelized through government policy, political stability or instability, corruption, foreign trade policy, tax policy, labour law, environmental law and trade restrictions. Furthermore, government may have deep rooted control on the nation's education system, infrastructure and health regulations. All these factors have to be considered while assessing the attractiveness and viability of a potential market.

Economic factors:

Economic factors are determinants of a certain economy's performance. These factors are economic growth, exchange rates, inflation rates, interest rates, disposable income of consumers and unemployment rates. These factors may have a direct or indirect long term impact on a company, since these will affect the purchasing power of consumers and could possibly influence the demand / supply curve. Consequently, this will also affect the way companies price their products and services. On March 11, 2020, WHO declared COVID 19 as a pandemic affecting 213 countries world-wide. Significant economic impact occurred across the globe due to reduced productivity, loss of life, complete disruption of public health,business closures, trade disruption, global supply chain disruption etc. As a result, there was significant reduction in income, a steep rise in unemployment, disruptions in the transportation, tourism, service and manufacturing industries.

Social factors:

This aspect of the general environment represents the demographic characteristics, norms, customs and values of the population within which the organization operates. This includes population trends such as population growth rate, age distribution, income distribution, career attitudes, safety emphasis, health consciousness, lifestyle preferences and cultural barriers. These factors are important when the firm is targeting a group of customers. This apart, the firm gets an idea about the local work force and its availability.

Technological factors:

These factors refer to innovations in technology that may affect the operations of the industry and the market favourably or unfavourably. This points to technology incentives, the level of innovation, automation, R & D activity, technological change and the amount of technological awareness that a market possesses. These factors may influence decisions to enter or not to enter certain industries, to launch or not to launch certain products or to outsource production activities abroad. By knowing what is going on technology-wise, the strategist of the company might prevent the company from spending a lot of money in developing a technology that would likely to become obsolete very soon due to disruptive technological changes elsewhere.

Environmental factors:

Environmental factors have been focused only relatively recently. They have gained importance only when we have felt the increasing scarcity of raw materials, when we have failed to reach the pollution targets and carbon footprint targets set by governments. These factors include ecological and environmental concerns such as weather, climate, environmental offsets and climate change which will invariably affect various industries, tourism, farming, agriculture and insurance. Furthermore, growing awareness of the potential impacts of climate change is affecting how companies should operate and the products they offer to have sustainable development. This has led to increasing number of companies getting more and more involved in practices such as Corporate Social Responsibility (CSR) and sustainability.

Legal factors:

Although these factors may have some overlap with the political factors, they include more specific laws such as antitrust laws, discrimination laws, employment laws, competition laws, consumer protection laws, copyright and patent laws, and health and safety laws. It is clear that companies need to know what is and what is not legal in order to trade successfully and ethically. If an organization trades globally this becomes all the more important to know the legal aspect of trade. Because, each country has their own set of rules and regulations. Moreover, the strategist must be aware of any potential changes in legislation and the impact it may have on the businessin future. All these problems necessitates the appointment of a legal advisor in the organization.

4.1.12 Examples of PESTEL Analysis

PESTEL Analysis of The Banking Industry

Following is the comprehensive list of factors that affect the banking industry:

Political factors

Government can intervene in the banking sector whenever necessary, leaving the industry exposed to a lot of political pressures, corruption, apart from specific rules and regulations like trade restrictions, labour laws, tariffs, change in repo rates etc.

Economic factors

The amount of capital accumulation in the banking sector depends on the income flow in the economy. Inflation affects the banking sector adversely. Similarly, the exchange rate is another factor which affects the banking sector globally. Recently, the Covid 19 pandemic has disrupted all kinds of economic activities all over the world. This has resulted in a direct impact on the income flow and purchasing power of households. Lack of demand has further reduced private and public investment. All these affected the banking sector adversely.

Socio-cultural factors

Buying behaviour of the households in respect of necessities and luxuries and all other cultural influences affect the banking sector. Changing social trends affect people's preferences which in turn affect the growth of the banking business.

Technological factors

Technology has added a lot of convenience to the banking sector by providing online mobile apps to facilitate transfer of funds, account handling, pay bills and other sundry services through netbanking. However, amidst all these technological advantages, the shadow of the problem of security and privacy is growing longer. So, banks have to spend a lot of money to keep all these problems in check.

Environmental factors

With technological advancement, the practice of net banking through mobile apps has reduced the amount of paper used. This has reduced considerably if not prevented altogether the felling of the trees. It has also minimized individual environmental footprints as customers can now apply for credit/debit cards and look at banking FAQs online.

Legal factors

The banking industry is governed by several federal laws and follows strict rules regarding privacy, trade structures and consumer laws. The most fearful situation in the banking industry is the accumulation of "Non-performing assets" (NPA). So the legal risks are quite high in this industry when borrowers refuse to repay the loans which give rise to NPA.

PESTEL Analysis of Uber, A Leading Taxi Service Provider

Following is the list of the factors that affect Uber:

Political factor

- To deal with the bans in many countries
- To follow minimum wage rules
- To follow the rules of drivers' insurance

Economic factor

- Reasonable fare charges
- Accessible easily without any hassle
- Offers job opportunities

Social factor

- Offers better ride experience than other taxi service
- User friendly

- Quick pick up than others like Meru, Mega and Ola

Technological factor

- Excellent mobile app for users
- Using social media and other electronic media well for promotion

Environmental factor

- Usage of automobile fuel may increase
- City traffic congestion may also increase

Legal factor

- Need to prevent ban on UBER in many countries
- Need to follow labour and employee safety laws
- Country-specific Patent laws are also a big concern

4.1.13 Emerging Dimensions of VUCAFU

VUCA is an acronym, first used in 1987 based on the Transformational leadership theories of Warren Bennis and Burt Nanus (1985), to describe or to reflect on the volatility,uncertainty, complexity and ambiguity of the external environment. Because of this new and completely unpredictable environment, it is almost impossible to predict threats or opportunities. However, at the same time the potential for disruption is very high. The US army war college introduced the concept of VUCA to describe the volatile,uncertain, complex and ambiguous multilateral world perceived as resulting from the end of the "Cold war". It was vital to establish an ability for defense amidst complete uncertainty.

With the onset of Covid 19 pandemic which engulfed the entire globe like wild fire, two more letters have been added to VUCA which are FU to represent the "Fear of unknown and unprecedentedness". As the corona virus (COVID – 19) pandemic sweeps across the world, it is causing unprecedented widespread concern, fear and stress, all of which are natural and normal reactions to the unknown and uncertain situation that everyone find themselves in. The strategists of most of the organizations are at a loss as to how to cope with such a fearful unprecedented situation.

Emerging Dimensions of VUCAFU and Porter 5 Analysis

4.2

4.2.1 Dynamics of the VUCAFU World

In order to understand the dynamics of the VUCAFU world, we have to have a closer look at the different dimensions of it. The dimensions are as follows:

Volatility

Volatility is a statistical measure on one hand, which describes an amount of uncertainty. On the other hand, it is a concept that refers to the speed, volume, nature and magnitude of a change that may or may not be in a pattern form. The change may occur in an industry, in a market or in the world in general. The more volatile the world is, the more and faster things change. The challenge is unexpected and unstable and may be of unknown duration. For example, violent fluctuations in prices after a natural disaster catch the supplier on the wrong foot. Here the solution may lie in the stock piling of the inventory. Other examples may include fluctuations in the stock market and innovations in technology and digitalization. Proper risk management may solve the stock market fluctuations, while quick adoption of new technology will help the organization grow at a faster pace and will retain its competitive advantage.

Uncertainty

Uncertainty refers to the extent to which we can confidently predict the future. Keeping in mind volatility, uncertainty becomes the ability to predict or not to predict what will happen amidst volatility. When there are no concrete trends or patterns, it becomes more and more difficult to establish what will happen next and to make decisions based on that. Uncertainty is lack of clarity to evaluate a situation properly to identify challenges and opportunities.

However, decision making under uncertainty by the strategist of the business firm is possible with the help of "Game Theory". The condition of uncertainty occurs when the decision maker has no information about the probability of the occurrence of different states of nature. The "Minimax rule" put forward by Neumann and Morgenstern states that the decision maker should minimize the maximum loss. Similarly, the "Maximax rule" states that that strategy should be chosen which maximises the maximum possible profit. The Bayes' rule is another method which the strategist of a business firm adopts in making decisions under uncertainty. For example, the launching of the product of a prospective competitor may destroy the business of an established product and the future of its market plunges into uncertainty. In order to tackle such a problem, the business firm should invest in collecting, interpreting and sharing information so that it can pre-empt. Information analysis networks help reduce the effect of uncertainty.

Complexity

When environment is volatile and uncertain, the situation as such automatically becomes more complex. This happens because the cause and effect are no longer linear. So, it becomes a challenge to discern which development has led to which consequence. Complexity describes the amount of diversified states a system can get into at a certain point of time. The more diversified states a system can get into, the harder it gets to manage these states. Particularly, when it comes to long term events. It is often impossible to determine when or why a particular development took place and what factors influenced it.Under high complexity, it is impossible to fully analyze the environment and come to rational conclusions. The more complex the world is, the harder it is to analyze. Suppose, a multi-national company is doing business in many countries, all with unique regulatory environment, tariffs and cultural values. The strategists would like to restructure and develop specialists and build up resources which will be adequate to address the complexity.

At the same time a complex environment may be created when an action that is deliberately taken, has led to multiple and very different outcomes not in conformity with the expectation, for example, organizational alliance. This may involve complex legal implications.

Ambiguity

When a situation cannot be clearly interpreted, its meaning not discerned and the causality not determined – such a situation is termed as ambiguous. This may happen when information is incomplete, contradictory or too inaccurate to draw clear conclusions. Ambiguity does not imply a lack of clarity – rather it describes a situation where multiple interpretations are possible and all are equally valid. In other words, there is no right solution. This is because there may be many possible solutions and there is no analytical way to establish which one is the correct way to follow. Suppose, a business firm decides to sell its product in an immature or emerging market or decides to launch products outside the core competencies. As a solution to this problem, the strategists would like to conduct experiments. Understanding cause and effect requires generating hypotheses and testing them. The experiments should be designed in such a way that the lessons learned can be applied fruitfully.

In practice, the four terms volatility, uncertainty, complexity and ambiguity are related. The more complex and volatile an environment is, for example, the harder it is to predict and therefore, more uncertainit will be. Yet, all the four represent distinct elements that make our environment – the world, a market or an industry – very difficult to grasp and control.

Fear of Unknown and Unprecedentedness

When the external environment is such that the business firms are engulfed by a fear of unknown dimension because of an unprecedented catastrophe that their strategists are completely dumb founded which renders them extremely helpless. The classic example of this is COVID-19 (corona virus borne disease) pandemic.

The impact of COVID-19 pandemic is being felt by all the business firms around the world. The entire globe is reeling under the third wave of the pandemic in the early 2022. This is because of the fact that the "Novel Corona virus" which started spreading the disease from China in late 2019, is mutating continuously and changing the nature of the virus. The different strains of corona virus are Alpha, Beta, Gamma, Delta, Omicron etc. Scientists and doctors have failed to predict how many waves of the pandemic are yet to come.

As COVID-19 has created unprecedented economic uncertainty and loss, maximizing returns, managing risk and ensuring the continued health of the business, demands a deep understanding of changing market conditions and Govt. policy. Infrastructure investments might pave the way to post-pandemic recovery reinforced by sustainable and resilient growth. For example, "PM- Gati Shakti" – a new project has been introduced in Indian Budget 2022, to boost up the infrastructure in a big way..

The outbreak of the virus is spurring the adoption of contactless digital payments and there has been a surge in digital payment volumes across online grocery stores, retail outlets, online pharmacies etc. National Payments Corporation of India (NPCI) has been pivotal to the emergence of the digital payment ecosystem in India. Indian Finance Minister has assured that Central Bank Digital Currency will be issued very soon which will give a big boost to digital economy.

In order to overcome this unprecedented situation, business leaders are navigating a broad range of interrelated issues that span from keeping their employees and customer safe through "work from home" and "contactless transaction" respectively, providing support of cash and liquidity, re-orienting operations and navigating complicated government support programmes.

Exercise

Theoretical Questions

I. Multiple Choice Question (MCQ)

1. Profit is the difference between………

   (a) Total cost and total revenue

   (b) Total revenue and total cost

   (c) both A & B

   (d) None

2. The internal business environment includes factors such as

   (a) business philosophy & business priorities

   (b) management structure

   (c) capital structure

   (d) All

3. The term 'T' in SWOT Analysis is

   (a) Transparency

   (b) Total revenue

   (c) Threat

   (d) Transaction

4. The components of micro business environment are-

   (a) Firms and consumers

   (b) Market & competitors

   (c) Organization

   (d) All

5. The term 'S' in PESTEL stands for-

   (a) Strength

   (b) Socio-economic

   (c) Sustainability

   (d) None

II. State True (or) False:

1. Good business environment helps the progress of a particular firm
2. The term 'P' in PESTEL stands for Perceptions

3. Demographic factor is associated to the boundary of a country
4. Globalization leads to concentration upon domestic economy
5. Health and education are the components of socio-economic factors.

III. Fill in the blanks

1. A PESTEL analysis is used to identify threats and ……………………
2. The political factors in PESTEL are about how and to what extent a ………………
3. The main purpose of globalization is to form…………………… blocks
4. SWOT Analysis means Strength, ……………, …………………. and Threat
5. Demographic Environment of Business is mainly dependent on …………..

IV. Match the following

Column A	Column B
1. Demographics	A. Competitors
2. Macro Business Environment	B. Business Firms
3. Micro Business Environment	C. Population
4. SWOT Analysis	D. Rival sellers
5. Porter’s Force	E. Political-Legal

V. Short Essay Type Questions

1. Define Business Environment and Economic Environment.
2. Make discussion on micro business environment.
3. Discuss about micro business environment.
4. Explain SWOT Analysis.
5. Write the importance of SWOT analysis in business.
6. Discuss the PESTEL Analysis.
7. Explain the impact of PESTEL Analysis upon the performance of the business houses.
8. Write in brief the factors in the PESTEL.
9. Make PESTEL analysis on banking industry.
10. Explain the use of PESTEL analysis in any taxi service provider.

Answer:

I. Multiple Choice Question (MCQ)

1	2	3	4	5
b	d	c	d	b

II. State True or False

1	2	3	4	5
T	F	F	F	T

III. Fill in the blanks:

1	weaknesses	2	Government intervenes
3	trade	4	weakness, opportunity
5	population size		

IV. Match the following

1	2	3	4	5
C	E	A	B	D

SECTION - B
FUNDAMENTALS OF MANAGEMENT

FUNDAMENTALS OF MANAGEMENT 5

This Module includes:

FUNDAMENTALS OF MANAGEMENT

Module Learning Objectives:

After studying this Module, the students will be able to –

- Learn the fundamental concepts of management.
- Develop a detail understanding of Stewardship theory and Agency theory that explain the dynamics of relationship between the owner and the manager in an organization.
- Appreciate various functions of management.
- Understand various aspects of organization structure and importance of responsibility and accountability in delegation of authority.
- Develop an overview of various theories of leadership and motivation.
- Appreciate the types and process of decision making in an organization.

Introduction to Management

5.1

Management as the name suggests itself is related with managing other men tactfully to achieve some predetermined goals. In every walk of the life management has its own application since to achieve certain goals in an organized manner adherence to the basic principles of management is a sine qua non. From the theories of economics it was apparent that out of four factor of productions the last but not the least factor is the entrepreneurship which is nothing but the organizing skill, administrative ability and enterprising initiative of the management. Thus, management provides leadership to a business enterprise.

Without able managers and effective managerial leadership the resources of production remain merely resources and never become production. Under competitive economy and ever-changing environment the quality and performance of managers determine both the survival as well as success of any business enterprise. Organisations must acquire and allocate the resources necessary to achieve their goals. How successfully an organisation achieves its goals, objectives, satisfies social responsibilities or both depends, to a large extent on its managers. If managers do their jobs well, the organisation will probably achieve its goals. Managers at every level plan, organise, lead, and control their organisations. Managers may be called as organisational planners, organisers, leaders and controllers. Managers are in constant action.

Virtually every study of managers in action has found that they "switch frequently from task to task, changing their focus of attention to respond to issues as they arise, and engaging in a large volume of tasks of short duration." Mintzberg (1973) observed CEOs on the job to get some idea of what they do and how they spend their time. He found, for instance, that they averaged 36 written and 16 verbal contacts per day, almost every one of them dealing with a distinct or different issue. Most of these activities were brief, lasting less than nine minutes. Kotter (1999) studied a number of successful general managers over a five-year period and found that they spend most of their time with others, including subordinates, their bosses, and numerous people from outside the organization. Kotter's study found that the average manager spent just 25% of his time working alone, and that time was spent largely at home, on airplanes, or commuting. Few of them spent less than 70% of their time with others, and some spent up to 90% of their working time this way.

Management is a distinct function and so it can be separately studied. It consists of some basic and interrelated activities. It is a way or a discipline, which adds effectiveness to human efforts and brings order to them. As a process it has a dynamic aspect. It is developing as a distinct branch of sociology. But there are some difficulties with regard to the terminology. The people who perform management are also known as 'the management.' It is perhaps better to use the word 'managing' to denote the function of management.

Management has developed and grown in leaps and bounds from a nearly insignificant topic in the previous centuries, to one of the integral ones of our age and economy. Management has evolved into a powerful and innovative force on which our society depends for material support and national well-being. The period between 1700 and 1850 is highlighted by the industrial revolution and the writings of the classical economists. According to Peter Ferdinand Drucker awareness of and then to stress on management came as a result of World War II. It was, above all, the performance of American manufacturing industry during the war that drew attention to management. The management boom, however, was triggered by a non-American. Sir Stafford Cripps (1889-1952), Chancellor of the Exchequer in Britain's first postwar Labour government, was a convinced socialist. But it was Cripps who conceived of management as the force that could restore the British economy and could provide the impetus for its growth and performance. It was Cripps who invented the productivity teams of British businessmen and managers who were being sent to the United States to learn the secrets of management. A few years after the start of the exchange of productivity teams between Britain and America, the Marshall Plan was mounted, and management received a central place in it. The Marshall Plan set out to mobilize management for economic and social reconstruction. The success of the Marshall Plan made management a best seller. Suddenly everybody talked management, everybody studied management. It was not much later that the Japanese followed the West. The Japanese first talked of a management boom when, after 1950, Japanese government and Japanese business, regaining autonomy after years of American occupation, began systematically to work on rebuilding the Japanese economy. They seized upon management as the central force and the critical factor. Concern with management rapidly spread to the developing countries. In India and in Brazil, in the newly independent countries of Africa, and in Southeast Asia management associations were formed, management schools came into being, management began to become a major focus of governmental as well as of business concern. Eventually the management boom reached the communist world. One communist country after another in Europe—beginning with the heretic Yugoslavs and followed by the Poles, the Hungarians, and the Czechs—set up management schools and management institutes, began to translate Western, especially American, management books, and began to teach management as the solution to economic stagnation.

5.1.1 Definition of Management

The conventional definition of management is "getting work done through people, but real management is developing people through work"- Agha Hasan Abedi. The person who directs the efforts of others is known as manager. Management may be defined in many different ways. Many eminent authors on the subject have defined the term "management", some of these definitions are reproduced below:

- According to Lawrence A Appley, "Management is the development of people and not the direction of things".
- According to Joseph Massie, "Management is defined as the process by which a co-operative group directs action towards common goals".
- As per George R Terry, "Management is a distinct process consisting of planning, organising, actuating and controlling performed to determine and accomplish the objectives by the use of people and resources".
- According to James L Lundy, "Management is principally the task of planning, co-ordinating, motivating and controlling the efforts of others towards a specific objective".
- In the words of Henry Fayol, "To manage is to forecast and to plan, to organise, to command, to co-ordinate and to control".
- According to Peter F Drucker, "Management is a multi-purpose organ that manages a business and manages managers and manages worker and work".
- J.N. Schulze defines "Management is the force which leads, guides and directs an organisation in the accomplishment of a pre-determined object".
- According to Koontz and O'Donnel, "Management is defined as the creation and maintenance of an internal environment in an enterprise where individuals working together in groups can perform efficiently and effectively towards the attainment of group goals".
- According to Ordway Tead, "Management is the process and agency which directs and guides the operations of an organisation in realising of established aims".

- According to Stanley Vance, "Management is simply the process of decision-making and control over the actions of human beings for the express purpose of attaining pre-determined goals".
- According to Wheeler, "Business management is a human activity which directs and controls the organisation and operation of a business enterprise. Management is centred in the administrators of managers of the firm who integrate men, material and money into an effective operating limit".
- In the words of William Spriegel, "Management is that function of an enterprise which concerns itself with the direction and control of the various activities to attain the business objectives".
- In the words of S. George, "Management consists of getting things done through others. Manager is one who accomplishes the objectives by directing the efforts of others".
- In the words of Keith and Gubellini, "Management is the force that integrates men and physical plant into an effective operating unit".
- According to Newman, Summer and Warren, "The job of management is to make cooperative endeavour to function properly. A manager is one who gets things done by working with people and other resources".
- According to John F M, "Management may be defined as the art of securing maximum results with a minimum of effort so as to secure maximum results with a minimum of effort so as to secure maximum prosperity and happiness for both employer and employee and give the Notes public the best possible service".
- In the words of Kimball and Kimball, "Management embraces all duties and functions that pertain to the initiation of an enterprise, its financing, the establishment of all major policies, the provision of all necessary equipment, the outlining of the general form of organisation under which the enterprise is to operate and the selection of the principal officers. The group of officials in primary control of an enterprise is referred to as management".
- In the words of E.F.L. Brech, "Management is a social process entailing responsibility for the effective and economical planning and regulation of the operations of an enterprise, in fulfilment of a given purpose or task, such responsibility involving: judgement and decision in determining plans and in using data to control performance, and progress against plans; and the guidance, integration, motivation and supervision of the personnel composing the enterprise and carrying out its operations".
- According to E. Peterson and E.G Plowman, Management is "a technique by means of which the purpose and objectives of a particular human group are determined, classified and effectuated".
- According to Mary Cushing Niles, "Good management or scientific management achieves a social objective with the best use of human and material energy and time and with satisfaction for the participants and the public".

From the definitions quoted above, it is clear the "management" is a technique of extracting work from others in an integrated and co-ordinated manner for realising the specific objectives through productive use of material resources. Mobilising the physical, human and financial resources and planning their utilisation for business operations in such a manner as to reach the defined goals can be referred to as "management". If the views of the various authorities are combined, management could be defined as "a distinct ongoing process of allocating inputs of an organisation (human and economic resources) by typical managerial functions (planning, organising, directing and controlling) for the purpose of achieving stated objectives namely – output of goods and services desired by its customers (environment). In the process, work is preformed with and through personnel of the organisation in an ever-changing business environment".

5.1.2 Nature of Management

Based on the above discussion on the definition of management the salient features of management can be identified as follows-

1. **Result Orientation:** Manager's primary task is to secure the productive performance through planning, direction and control. It is expected of the management to bring into being the desired results. Rational utilisation of available resources to maximise the profit is the economic function of a manager. According to Kimball, "management is the art of applying the economic principles that underlie the control of men and materials in the enterprise under consideration".

2. **Humane Approach:** Management involves doing the job through people. The economic function of earning profitable return cannot be performed without enlisting co-operation and securing positive response from "people". In the words of Koontz and O'Donnell, "Management is the art of getting things done through people in formally organised groups".

3. **Process centric:** Management is a process, function or activity. This process continues till the objectives set by administration are actually achieved. Accroding to George R. Terry, "Management is a distinct process consisting of planning, organizing, actuating and controlling, performed to determine and accomplish stated objective by the use of human beings and other resources".

4. **Universal activity:** Management is not applicable to business undertakings only. It is applicable to political, social, religious and educational institutions also. Management is necessary when group effort is required.

5. **Management is a science as well as an art:** Management is an art because there are definite principles of management. It is also a science because by the application of these principles predetermined objectives can be achieved.

6. **Management is a science as well as an art:** Management is on one hand an art because there are definite principles of management. On the other hand, management is also a science because by the application of these principles predetermined objectives can be achieved.

7. **Management is a group activity:** Management is always concerned with group efforts and not individual efforts and also used to perform in group level rather than on individual level.

8. **Management is a system of authority:** Management has an authoritarian set up which formalises a standard set of rules and procedure to be followed by the subordinates and ensures their compliance with the rules and regulations.

9. **Management involves decision-making:** Management implies making decisions regarding the organisation and operation of business in its different dimensions.

10. **Management implies good leadership:** A manager must have the ability to lead and get the desired course of action from the subordinates. According to R. C. Davis, "management is the function of executive leadership everywhere". Management of the high order implies the capacity of managers to influence the behaviour of their subordinates.

11. **Management is dynamic activity:** The principles of management are dynamic and not static. It has to adopt itself according to social changes.

12. **Multidisciplinary:** Management is an interdisciplinary study. It draws ideas and concepts from various disciplines like economics, statistics, mathematics, psychology, sociology, anthropology etc.

13. **Goal oriented:** Management is result-oriented activity. It strives to achieve the predetermined targets with available resources.

14. **Levels of management:** Different hierarchy of management can be observed in terms of top level, mid level and lower level based on the nature and importance of activities.

15. **Management need not be owners:** It is not necessary that managers must be the owners of the enterprise. In joint stock companies, management and owners (capital) are different entities.

16. **Management is intangible:** The outputs of the management can't be witnessed in plain eyes, it can be felt. The results of management can be witnessed in terms of improved performance, profitability, productivity etc.

5.1.3 Is Management a Science or an Art?

An issue that often arises whether management is a science or art. It is said that "management is the oldest of arts and the youngest of sciences". This explains the changing nature of management but does not exactly answer what management is? To have an exact answer to the question it is necessary to know the meanings of the terms "Science" and "Art".

According to the nature of management, there is a controversy that whether management is a science or an art. This controversy is very old & is yet to be settled.

Management as a Science

Science is a systematised body of knowledge pertaining to a particular field of enquiry. It contains concepts, hypotheses, theories, experimentation and principles to explain cause and effect relationship between two or more factors. The following characteristics should be recognised as a science.

1. **Universally Accepted Principles:** Scientific principles represent basic truth about a particular field of enquiry. These principles may be applied in all situations, at all time & at all places. Management also contains some fundamental principles which can be applied universally like the Principle of Unity of Command i.e. one man, one boss. This principle is applicable to all type of organization – business or non business.

2. **Experimentation & Observation:** Scientific principles are derived through scientific investigation & researching i.e. they are based on logic. Management principles are also based on scientific enquiry & observation and not only on the opinion of Henry Fayol. They have been developed through experiments & practical experiences of large no. of managers, e.g. it is observed that fair remuneration to personal helps in creating a satisfied work force.

3. **Cause & Effect Relationship:** Principles of science lay down cause and effect relationship between various variables. E.g. lack of parity (balance) between authority & responsibility will lead to ineffectiveness.

4. **Test of Validity & Predictability:** Validity of scientific principles can be tested at any time or any number of times i.e. they stand the time of test. Each time these tests will give same result. Moreover future events can be predicted with reasonable accuracy by using scientific principles.

   E.g. principle of unity of command can be tested by comparing two persons – one having single boss and one having 2 bosses. The performance of 1st person will be better than 2nd.

Management as an Art

Art signifies the application of knowledge and personal skills to bring about desired results. Art has the following features:

1. **Practical Knowledge:** Every art requires practical knowledge therefore learning of theory is not sufficient. It is very important to know practical application of theoretical principles. E.g. A manager can never be successful just by obtaining degree or diploma in management; he must have also known how to apply various principles in real situations, by functioning as a manager.

2. **Personal Skill:** Although theoretical base may be same for every artist, but each one has his own style and approach towards his job. That is why the level of success and quality of performance differs from one person to another. E.g. Every manager has his own way of managing things based on his knowledge, experience and personality, that is why some managers are known as good managers (like Aditya Birla, Rahul Bajaj) whereas others as bad.

3. **Creativity:** Every artist has an element of creativity in line. That is why he aims at producing something that has never existed before which requires combination of intelligence & imagination. Management is also creative in nature like any other art. It combines human and non-human resources in a useful way so as to achieve desired results. It tries to produce sweet music by combining chords in an efficient manner.

4. **Perfection through practice:** Practice makes a man perfect. Every artist becomes more and more proficient through constant practice. Similarly, managers learn through an art of trial and error initially but application of management principles over the years makes them perfect in the job of managing.

5. **Goal-Oriented:** Every art is result oriented as it seeks to achieve concrete results. In the same manner, management is also directed towards accomplishment of pre-determined goals. Managers use various resources like men, money, material, machinery & methods to help in the growth of an organization.

Management as both Science and Art

Management is both an art and a science. The above mentioned points clearly reveal that management combines feature of both science as well as art. It is considered as a science because it has an organized body of knowledge which contains certain universal truth? It is called an art because managing requires certain skills which are personal possessions of managers. Science provides the knowledge & art deals with the application of knowledge and skills.

5.1.4 Scope of Management

The scope of management is too wide to be covered in a few pages. Herbison and Myres have yet tried to restrict it under three broad groups, viz.

1. Economic Resource
2. System of Authority
3. Class or Elite

Let us understand each of them one by one.

1. **Economic Resource:** Business Economics classifies the factors of production into four basic inputs, viz. land, labour, capital and entrepreneur. Management ensures that using these basic factors of production it is possible to achieve higher growth trajectory with sustainable profit in long run. Thus management itself serves as an economic resource.

2. **System of Authority:** Management formalises a standard set of rules and procedure need to be adhered to by the subordinates and ensures their compliance with the rules and regulations.

3. **Class or Elite:** Management is considered to be a distinct class that has its own value system. Managerial class, often referred to as a collective group of those individuals that perform managerial activities is essential component of each organisation.

5.1.5 Management – An Emerging Profession

Any specialized activity becomes a profession provided it satisfies the following characteristics:

1. There must be a systematized body of knowledge which is used either in instructing, advising or guiding others,

2. Existence of a formal method and system for teaching and training people with that knowledge and skill,
3. A scope for creating posts of consultants for that skill,
4. Formation of an association by such consultants,
5. Existence of a code of conduct among such professional men and
6. Readiness to respond to the needs of man.

By closely studying the position of management we find that it does not satisfy all the characteristics in full although attempts are going on to develop it into a fully-fledged profession.

Case Study

Is Management Really a Profession?

–by Jena McGregor

Doctors must take the Hippocratic Oath and earn continuing education credits for years. Lawyers must pass the bar and adhere to strict codes about attorney-client privileges. But although managers have long been known colloquially as "professionals," the graduate schools many of them attended have long drifted away from their founding charters, which wanted to create a profession of management.

That's the argument made by Rakesh Khurana, a Harvard Business School professor, in his book, From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession. Khurana, who made a name for himself with his 2004 book, Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs, is a star at HBS, and builds a fascinating argument for why business school education is in need of reform.

Khurana defines a profession as one in which its practitioners have to master a certain body of knowledge, in which that knowledge is used to help others, and in which there's a governance system that's both ethical and self-policing in nature. None of those really describe management: Anyone can become a manager, whether or not they have an MBA; it's not really done to aid a client; and there is no self-policing body making sure ethical standards are met. Khurana argues that while the founders of today's elite business schools tried to legitimize business education by calling it a profession (no self respecting elite institution at the time wanted to have anything to do with something so tied to making money), today, it's become anything but.

Khurana believes we're at an "inflection point of what the role of business should be," and as pressures build to create corporations more attuned to benefiting society, we also need to educate future managers to do the same. He suggests that business schools could have some way of proving their students have mastered the curriculum (a board exam for MBAs?) and that there should be some "evergreen" aspect to the MBA (continuing education requirements, for instance). He adds that in "Rakesh's normative world," there might even be an equivalent of the Hippocratic Oath for business students. He even has a suggestion for the first sentence: "First, I will not lie."

Question:

What do you think? Should management be more of a profession?

Source: Business Week

Summary:

- It is very important to understand the systems framework in which an organisation operates.
- It is very useful concept for the understanding of business operations by identifying the critical sub-systems, their inter-linkages and inter-dependence for the achievement of common objectives.

- Management is the main aspect of working involved in a system & its involvement as art, science, profession leads an effective role.

Keywords:

- **Art:** It is the bringing about a desired result through the application of skills.
- **Administration:** It is a higher-level function concerned with the determination of policies.
- **Code of conduct:** It prescribed the norms of professional ethics for its members.
- **Economic Resource:** Management, land, labour and capital.
- **Goal-oriented:** Purposeful activity towards achieving the goals of the organisation.
- **Management:** The art of getting things done.
- **Process:** A series of functions that lead to the achievement of certain objectives.
- **Professionalisation:** It means defining the duties and responsibilities of the managers to improve the quality of management education and training.
- **Science:** A systematically organised body of knowledge including concepts, principles and theories.
- **Top management:** Managers who are higher up in the hierarchy devoting more time on administrative functions.

Stewardship Theory and Agency Theory of Management

5.2

5.2.1 Stewardship Theory

This theory is developed by Davis, Schoorman and Doanldson (1997) which is based on assumptions of agency theory of self-interested manager rationally maximizing his/her own economic gain. However, this individualistic model is associated on the notion of an in-built conflict of interest between shareholders and managers. This problem can only be solved through vigilant monitoring, and incentive schemes based around money, promotions and negative sanctions. But, Donaldson (1990) opines 'students of human behaviour have identified a much larger range of human motives including needs for achievement, responsibility, and recognition, as well as altruism, belief, respect for authority, and the intrinsic motivation of an inherently satisfying task' (Wood and Bandura, 1989). Stewardship theory is about the principal-manager relationship. Theory suggests that both parties can choose to behave as stewards of the organization, and that the structural factors can influence the behavioral choice (Davis et al., 1997). The stewardship theory emphasizes that there is no conflict of interest between managers and owners, that the optimum governance structure allows coordination of the organization to be achieved most efficiently and effectively, and authorizes managers to act since according to this theory they are not opportunistic or greedy agents but good stewards who will strive towards protecting and increasing the interests of owners (Donaldson and Davis, 1991). Thus, stewardship theory views a strong relationship between managers' successful pursuit of the objectives of the enterprise, and not only the principal's satisfaction, but also that of other participants in the enterprise collective reward. According to Davis, Schoorman and Donaldson (1997), the managers being a steward of the company will try to protect and maximize shareholder's wealth through firm performance, since by doing so, his (steward's) utility functions will be maximized in turn. Stewards in loosely couple, heterogeneous organizations with competing stakeholders and competing stakeholders objectives are motivated to make decisions that they perceive are in the best interests of group. A steward who successfully improves the performance of the organization generally satisfies most groups, since most stakeholder groups have interests that are well served through increasing organizational wealth. With this benign view of management, stewardship theory takes a more relaxed view of the need to separate the roles of chairmanship and chief executive, and favours boards having a majority of specialist executive directors rather than a majority of non-specialist independent directors. But, the introducers of the concept Donaldson & Davis (1991) insist the theory is not an attempt to replace one form of determinism by another, but introduce a realistic note of contingency in a model based on principal-agent (managers) choice. However managers' choice is contingent on their psychological motivations and their perceptions of the situation. Principals (Owners or shareholders) also choose to create an agency or stewardship relationship, hinging on their perceptions of situation and the manager. Pearson and Marler (2010) argue that the leader's stewardship choice can motivate and facilitate reciprocal stewardship behavior from the employee. Likewise, Eddleston (2008) suggests that transformational leadership can lead to a stewardship culture.

The steward theory states that a steward protects and maximises shareholders wealth through firm Performance. Stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. The stewards are satisfied and motivated when organizational success is attained. It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. The employees take ownership of their jobs and work at them diligently.

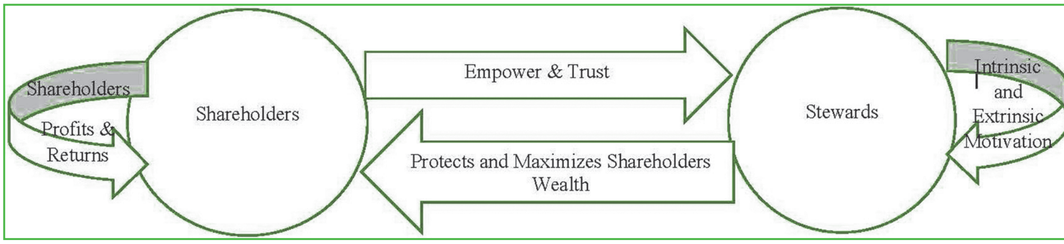


Figure 5.1 Diagram based on Stewardship Theory

5.2.2 Agency Theory

Since the early part of twentieth century, the corporate sector all over the globe had witnessed a phenomenal rise of joint stock companies resulting into an increasing tendency of divorce between ownership and management. It was become increasingly infeasible as well as undesirable to control a large, diversified and geographically dispersed company to be led by a single owner/owner group. That is why the necessity of entering into a contract with a professional executive to run day to day affairs of the company became imperative for achieving long term sustainable competitive advantage. However, as soon as the separation between the principal (owners/shareholders/investors) and agent (executive directors/outside directors) be made the everlasting question that arises is nothing but the conflict or overriding interests of both the parties attached to the company. This paradox arising out of the nexus of contracts among individual factors of production is well known as the 'Agency Theory' which was originated from the seminal papers of Alchian and Demsetz (1972), Jensen and Meckling (1976) and later elaborated by the work of Jensen and Fama (1983). However some authors (Letza, Sun and Kirkbride,2004) pointed out that the agency problem was effectively identified by Adam Smith in his influential book The Wealth of Nations when he argued that company directors were not likely to be careful with other people's money as with their own. For as long as knowledge is power, the superior power is with the agent: "Princip der Vorhand" said Wilhelm Roscher (21, p. 362 f.) 130 years ago. Moreover as per Jensen and Meckling (1976), the essence of the agency problem is the separation of management and finance. Managers raise funds from investors to employ them into productive and profitable venture and the financiers need the managers to generate a handsome return on their funds. So the agency theory suggests that shareholders are the principals in whose interests the corporation should be run even though they rely on others for the actual running of the corporation.

Generally agency theory problem may be classified into two broad categories namely Type-I Agency Problem and Type-II Agency Problem. At the heart of agency theory is the separation of ownership and management and the problems that arise from this separation (Eisenhardt, 1989). This owner-manager conflict is referred to as a Type I agency problem (Villalonga and Amit, 2006). Instead of the Type I owner-manager conflict, the Type II represents the conflict between majority and minority shareholders (i.e., family and nonfamily shareholders; Villalonga and Amit, 2006). An example of a Type II agency problem manifests itself in the misalignment of shareholder goals.

However, the agency theory had a number of disadvantages regarding the opportunism and self-interests of the agent may act for furtherance of increasing his market value or goodwill rather than exerting his utmost efforts for enhancement of shareholder value. Moreover, according to the agency theorists it was believed that the agent may misuse his power for pecuniary or other advantages and may not agreed to assume risks on behalf of principals interests because the agent may view these risks as not being appropriate for him to take because he and the principal may have different attitudes and perception towards the risk profile. Besides the problem of information asymmetry may crop up whereby the principal and agent may have different level of access to different levels of information and the former may be in disadvantageous position since the later had a better proximity to the information source.

In order to solve the agency problem, the theorists had suggested an increasing role for the board of directors to perform a transparent and effective surveillance role for ensuring better governance. According to Blair (1996), the managers are supposed to be the “agents” of a corporation’s “owners”, but the former must be monitored and the there should be some outsiders and independent arrangements to provide some checks and balances to make sure they do not abuse their power. Here the costs resulting from managers misusing their position and power, as well as the costs of surveillance and disciplining them to try to prevent abuse, bonding costs incurred by the agent, and reductions in welfare resulting from decisions taken by the agent which are inconsistent with maximization of principal’s welfare are known as “agency costs”. Apart from the ownership-management relationship as emphasized by agency costs, it also covered the relationship between company and creditor, and employer and employee, company and customer. Moreover, Shleifer and Vishny (1997) argue that the agency problem is an important element of the contractual view of the firm. The analysis then focuses on infeasibility of drafting complete contracts, and the associated complexities arising from incomplete contracts.

In the seminal paper by M.C. Jensen and W.H. Meckling (1976) agency costs were proposed to be a key tool in evaluating alternative designs of a principal-agent relation. The authors defined agency costs as the sum of (i) the monitoring expenditure by the principal, (ii) the bonding expenditures by the agent, and (iii) the residual loss, i.e. the monetary equivalent of the reduction in welfare experienced by the principal due to the divergence between the agent’s decisions and “those decisions which would maximize the welfare of the principal” (1976,p. 308). However, whenever agency costs in the sense of Jensen/Meckling/Fama can be calculated there is no need for monitoring, whenever there is a need for monitoring, agency costs cannot be calculated. Hart (1995) offers three reasons why principals and agents tend to write incomplete contracts. Firstly, it is difficult for people to think ahead and plan for all contingencies; secondly, it is difficult for the contracting parties to negotiate effectively, especially where prior experience may not be helpful guide; thirdly, it is hard for plans to be written down in such way that an outside authority, such as a court, will be able to interpret and enforce the contract. Moreover, Aghion and Bolton (1992) argue that- as a result of contractual incompleteness and wealth constraints- it is not feasible to resolve all potential conflicts between the agent and the principal.

However, according to Prof. Jensen (1994), the ‘efficient’ market is the best place to deal with the agency problem. It was believed that an efficient market mechanism will ensure effective corporate control, efficient management of labour and dissemination of corporate information. Consequently, according to Learmount (2002), it will be feasible to ensure that the management will bear the costs of its misconduct and will therefore create the incentives for self-control. It was also commented by Jensen & Meckling (1976) that the market was traditionally considered as one of the best place for judging management efficiency and the joint stock company known for popularizing the concept of separation of ownership and management ‘otherwise the millions of individuals are willing to turn over a significant fraction of their wealth to organizations run by managers who have so little interest in their welfare. Moreover, neoclassical economists see the market as the only way to organize efficient contracting, and the firm is viewed as a facilitator of constantly re-negotiated contracts.

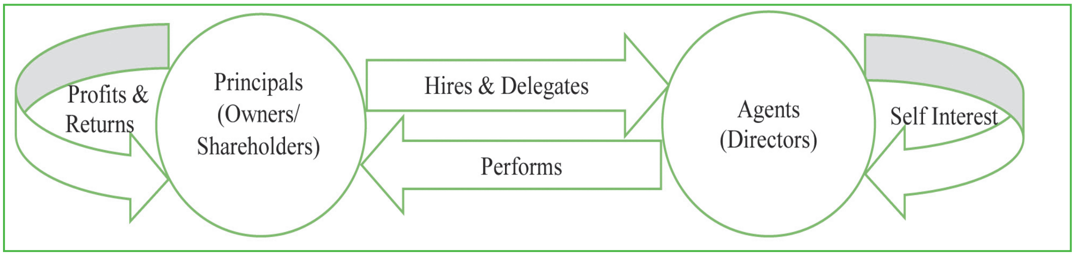
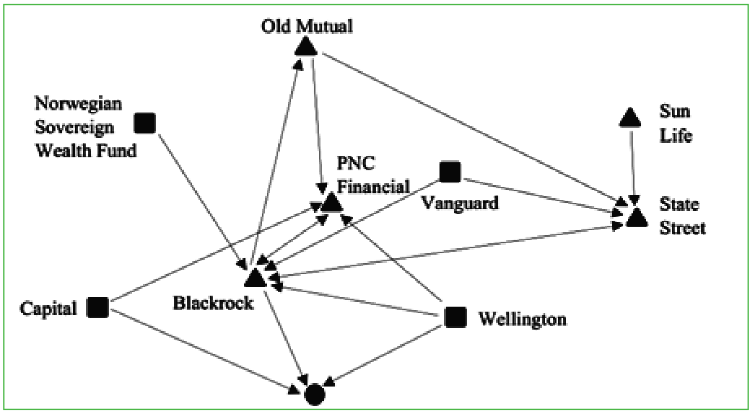


Figure 5.2 Diagram based on Agency Theory



- ● Listed Trading Company
- ▲ Listed Investment Company
- ■ Private Investment Company

Figure 5.3

5.2.3 Difference between Stewardship Theory and Agency Theory

Although both the Stewardship Theory and Agency Theory are considered to be as important doctrines of management yet they are significantly different based on a number of conceptual issues.

Issues	Stewardship Theory	Agency Theory
Theoretical Basis	Organizational Psychology and Sociology	Economics
Model of Man	Self-actualizing man	Economic Man
Behaviour	Collective serving	Self Serving
Motivations	Higher level needs (Growth, Self-Actualization Needs)	Lower level needs (Physiological, Security needs)
Performance Criterion	Stakeholder Value Creation	Shareholder Value Creation
Owner-management relationship	Goal alignment	Goal Conflict
Objective	Collectivism	Individualism
Cultural Differences	Low Power Distance	High Power Distance
Time Frame	Long Term	Short Term
Managerial motivation	Intrinsic	Extrinsic
General Approach to Uncertainty	Trust	Distrust
Managerial Behaviour	Acceptance	Avoidance
Representative Design	Advice as primary board role	Monitoring as primary board role
Locus of Decision Making	Large Discretion for Management decisions	Sharing Decision rights

The distinction between theories is found in the behavioral assumptions and the structural prescriptions. From a behavioral perspective, agency theory describes behavior rooted in an economic model of man; agent behavior will be based on self-interest and may conflict with the principal's interest. Stewardship theory describes behavior rooted in a more humanistic model of man; steward behavior will be based on serving others and therefore will align with the principal's interest. From a structural perspective, agency theory prescribes governance mechanisms that control and monitor agents in order to thwart opportunistic behavior and better align the goals of the principal and agent. Stewardship theory instead prescribes an organizational environment where stewards are trusted and empowered, and where control and monitoring mechanisms are not needed because goals of the principal and steward are already aligned. Both agency and stewardship theories suggest that performance is enhanced by the prescriptions set forth. Agency and Stewardship prescriptions and related performance outcomes can be described by the following diagram-

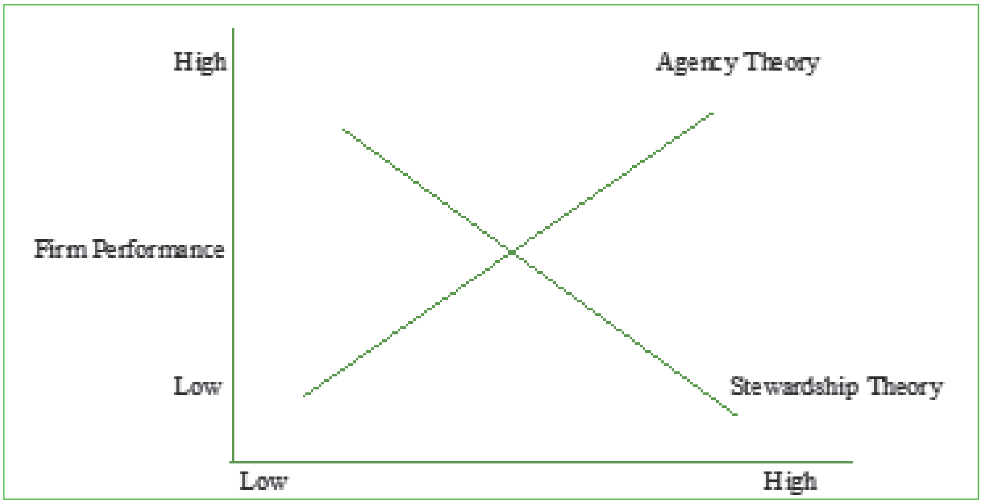


Figure 5.4 : Governance Mechanisms/Controls

As depicted, agency theory suggests that performance will increase when governance and control mechanisms are in place to monitor and curb the agent's opportunistic behavior (i.e., high levels of governance mechanisms, high level of performance).

Without these controls, it is assumed that agents will act opportunistically creating costs and lower levels of organizational performance (i.e., low levels of governance mechanisms, low level of performance). The opposite is theorized by the tenets of stewardship theory. According to stewardship theory, performance increases when the organizational structure is characterized by fewer monitoring and control mechanisms; this type of governance structure empowers and motivates stewards to pro-organizational behavior (i.e., low levels of governance mechanisms, high level of performance). With controls in place, it is assumed that stewards will feel betrayed and motivation and pro-organizational behavior will decrease (i.e., high levels of governance mechanisms, low level of performance).

Planning, Organizing, Staffing and Leading

5.3

5.3.1 Planning

Planning is an important function of management. Planning is an activity by which managers analyze present conditions to determine ways of reaching a desired future state. Planning is both an organisational necessity and a managerial responsibility. Through planning, organizations choose goals based on estimates or forecasts of the future. Concern for future is intensified by the fact of relentless, unremitting change. The purpose of planning, in the words of Dalton McFarland, is twofold: to determine appropriate goals, and to prepare for adoptive and innovative change.

Definition and Characteristics:

Planning is an intellectual process, the conscious determination of course of action, basing of decisions on purpose, facts and considered estimates (Harold Koontz and Cyril O'Donnell).

The plan of action is, at one and the same time, the line of action to be followed, the stages to go through, and methods to use. It is a kind of future picture wherein approximate events are outlined with some distinctness, whilst remote. According to George Terry, "Planning is the foundation of most successful actions of all enterprises".

Planning is defined as the activity by which managers analyse present conditions to determine ways of reaching a desired future stage. It embodies the skills of anticipation, influencing, and controlling the nature and direction of change. (Dalton McFarland)

Planning is the function that determines in advance what should be done. It consists of selecting the enterprise objectives, policies, programmes, procedures, and other means of achieving the objectives.

In planning, the manager must be able to manipulate abstract ideas and anticipate the impact of the many possible outcomes as they affect the enterprise as a whole (Theo Haimann).

Features of Planning:

(i) Planning is a primary function of management: When planning, the manager decides which of the alternatives should be followed, which policies, procedures, programmes, projects and so on would be set up.

(ii) Planning is goal oriented: Planning is aimed at defining the organisational goals and design appropriate action plans in order to achieve these goals.

(iii) Planning is an intellectual process : In the words of Theo Haimann, "Planning requires a mental predisposition to think before acting, to act in the light of facts rather than of guesses, and generally speaking to do things in an orderly way".

(iv) Planning is pervasive: Planning is all pervasive and it embraces all segments and levels in the organisation.

(v) Planning is continuous function: To keep the organization as a going concern, it is essential that planning must be done continuously.

(vi) Planning involves choice between alternatives: Planning involves choice among alternatives courses of action. If there is only one course, objective, policy, programme or procedure, perhaps then there exists no need for planning.

(vii)Planning is concerned with the accomplishment of group objectives: Planning is thus aimed at setting group goals and organisational goals rather than concentrating on individual goals.

(viii)Planning is flexible: No plan is rigid. When a plan is adopted, it chalks out a definite course of action. But the future assumptions upon which the planning is based may force managers to change the original plan.

Limitations of Planning:

(i) Inaccuracy: Formulation of future plans on the basis of wrong forecasts may not lead to the desired results.

(ii) Time-consuming: Planning involves determination of the major goals to be achieved. It is time consuming and it involves energy, time and mobilization of different kinds of resources.

(iii) Rigidity: Planning often gives some amount of rigidity to its policies, procedures, programmes and methods. A balance between stability and flexibility in planning is to be maintained.

(iv) Costly: Planning is costly because it requires money, time and information.

(v) Attitudes of Management: Good planning is an agonizing process - it is an intellectual activity. It requires tremendous amount of paper work and time. Most managers would not like to undergo such a painful process and prefer to become doers rather than thinkers.

(vi) Faulty design of planning system: Some of the limitations due to the design of planning system can be listed as under:

- **Lack of reward:** Planning system may not have reward mechanism and as such managers tend to address their attention to short run results of their performance which carried reward.
- **Lack of participation:** When planning is imposed from the authorities, it may lead to resentment and resistance among those who are forced to execute.
- **Lack of specific activities:** Planning cannot be effective unless the goals are specific and clear.
- **Competence of the planner:** A planner must possess not only skill, but intelligence and breadth of vision, and for long-range master planning must have the ability to forecast.

(vii)Planning prevents innovation: Planning demands total commitment to written policies, procedures, rules etc. It restricts a manager unnecessarily to defined areas.

(viii)Lack of orientation and training for managers: For most of the managers planning is easy to put off, as it is not at all exciting or action-oriented.

(ix) Uncertainty: Planning has to' reckon with numerous uncertainties in the environment.

Finally, planning is a mere ritual in a fast changing environment. The sudden and dramatic changes in technology, competition, government regulations, political, legal, ethical and social changes reduces the effectiveness of the planning effort.

Prerequisites of Effective Planning

Planning does not substitute facts for judgment. It does not substitute science for the manager. However, some general principles can be followed to make planning effective.

- Make plans simple and easy to understand. When the plan itself is complicated, it invites is understandings among the members of organization.
- Be selective in the plan. Successful managers never try to cover too much territory.
- Plan should be geared to meet, the needs of those who implement it.
- A plan should be thorough, it should not omit any function or sub-function and should not overlook any necessary details. At the same time, controversial statements should be avoided/ignored.

According to Gary Dessler, to plan effectively the managers should consider the following points:

(i) **Develop accurate forecasts:** Forecasting can be made accurate by educating the forecasting users in the art of relating the forecasting techniques to practical problems and also encouraging the people who are entrusted with the forecasting job to look into the informational needs of managers.

(ii) **Gain acceptance for the plan:** It is necessary to secure the acceptance and commitment from them. This can be done by soliciting the subordinate's participation in the planning process itself.

(iii) **Plan must be sound one:** To increase the efficiency of plans, managers are advised to follow an open-system approach where they recognize and pay concentration to the complex environment in which their organisation is functioning, apart from judging pros & cons of a plan.

(iv) **Develop an effective planning organisation:** Planning involves answers to several questions. The solution for these questions requires a blueprint for planning and a 'planning organisation' as such.

(v) **Be objective:** The managers should, not hesitate to verify the truth behind the pessimistic notions or beliefs. To see that planning is successful, managers must be objective.

(vi) **Measure firm's market value:** One of the primary responsibilities of a manager is to measure the total market and see that the organization's share in the market is as large as possible. For this the manager should estimate the firm's share in the market.

(vii) **Decide in advance the criteria for abandoning a project:** A plan should always include a specification, agreed on in advance for abandoning the plan. Managers should least hesitate in disconnecting the unproductive connections in the product/ project structure.

(viii) **Set up a monitoring system:** Plans should preferably be subjective to regular appraisal and review. Every plan should be refined and restructured on the basis of accurate and timely information.

(ix) **Revise the long-term plans every year:** Management should review long-term plans annually so as to match external opportunities with organisational resources in a proper way. By reviewing the progress made on the plan, the reasons for under performance or over-performance can be found out.

(x) **Fit the plan to the situation:** These days planning has become situational. A change in any part of the environment must be sensed and appropriate strategy must be determined to cope with the change".

Steps in Planning Process:

The process of planning consists of a series of interrelated steps which varies depending on the size and complexity of the organization. The basic steps involved in the process of planning are –

1. **Analysis of opportunities –** Planning starts with analysis of opportunities in the external environment as well as written the organization. Goals can be set only when a proper scanning of the environment, that reveals the opportunities that exist.
2. **Establishing Objectives –** The next step in planning process involves establishing objectives for the whole

organization, and for the different departments. Organisational objectives provide direction to the major plans

3. **Determining planning Premises –** Planning premises refer to the environment in which the plans are to be implemented. The task of determining premises should only be continued to those aspects that are critical to the plan.

4. **Identifying alternatives –** Different feasible alternatives need to be identified in order to achieve a particular objective, since there may be multifarious ways in which a particular goal can be accomplished.

5. **Evaluation of alternatives –** Alternatives needs to be evaluated in the light of goals. Those are set, and objectives to be achieved considering the various constraints and uncertainties that exist.

6. **Selection of the best alternative –** The choice of the best alternative, i.e. the selection of the most appropriate course of action. Sometimes two or more contingency plans are kept as a backup considering the unpredictability of the future.

7. **Implementing the plan –** Implementation or execution entails putting the plan into action. Managers need to consider a series of important decisions during implementation of the actions stated in the plan.

8. **Reviewing the Plan –** Reviewing the plan help managers to evaluate the effectiveness of the plan.

A system of thorough review and scrutiny can help in detecting derivations from the set plans and remedial measures can be taken accordingly.

Approaches to Planning

Independent of the above philosophies of planning, we may identify four different approaches to planning in actual practice in various organisations. These approaches are described as follows:

(a) **Top-down approach :-** As the name indicates, top management takes the initiative in formulating major objectives, strategies, policies and derivative plans in comprehensive manner and communities them down the line to middle and supervisory management levels for translating them into performance results. Managers other than those at top levels have little role in planning; they have only to concentrate on implementation and day-to-day control.

(b) **Bottom-up approach: -** This is a virtual reversal of the above approach in the sense that the plan proposals originate at the supervisory management level, travel up the management hierarchy in a step-by-step manner and reach the top management level for review and approval. In this approach top management generally refrains from giving any guidelines to lower management levels on what to plan and how.

(c) **Composite approach :-** Here the top management provides broad parameters and guidelines to line executives at middle and lower management levels, allows the needed flexibility and support to formulate tentative plans, which are reviewed and finalized by top management in consultation with all the managers at the appropriate levels. The approach is useful to evolve corporate-wide plans also, which partly draw inspiration from the planning ideas and perspectives generated at the lower level.

(d) **Team approach: -** In the approach, the task of planning is entrusted to a select team of managers, whether they are line managers or staff experts. The team functions under the leadership of the chief executive. It does not finalize plans as such but initiates the planning process, identifies the areas of problems and opportunities, examines the internal and external environment, collects information, solicits ideas and formulates tentative proposals for consideration by the chief executive. The team is used by the latter as his brains trust; it may even be asked to monitor the progress of plans and review performance.

Types of Plans:

To provide guidance to the managers to make decisions, take action and solve problems, various plans are drawn up. These plans help the managers in managing day to day affairs, utilizing resources of organization efficiently and in regulating working behaviour of subordinates. These plans do provide unifying and consistent base for managerial decision and action. These may be grouped into single use plans and standing plans.

(a) Standing Plans:- Standing plans are the recurring plans and they are used repeatedly in situations of a similar nature. A standing plan is used again and again over a long period of time. It is a standing guide to thinking and action. A standing plan is standing answer to recurring problems and it is of permanent or long term nature. Standing plans simplify the decision making process as they decide in advance what and how of a variety of operations. They make it possible for managers to spend their most creative efforts on single use plans. Standing plans are essential for smooth operations. Objectives, policies, procedures and rules are important standing plans.

(b) Single use Plans:- A single use plan is used once and then it is discarded. It is designed to fit the demands of a specific situation or goal and is 'used up' when the goal is achieved or the situation is over. A single use plan is used for a short period of time. Budgets, schedules; projects etc. are the examples of single use plans. Standing plans are prepared for repetitive activities while single use plans are meant for non-repetitive activities.

Planning Premises

Planning premises are basic assumptions about the environment in which plans are expected to be implemented. Certainly, planning has to take into account numerous uncertainties in its environment. Premises guide effectively planning. As pointed out by Harold Koontz, planning premises spell out stage of the expected future event which is believed will exist when plans operate. They are the expected environment of plans. Planning premises are largely derived from forecasting. The effectiveness of planning to a great extent depends on how accurately the premises are developed from out of the forecasting data. Though it is not possible to predict accurately future environmental conditions, planning has necessarily to be based on certain assumptions about the environment. These assumptions are captured in the form of planning premises.

Planning premises can be categorized into three heads —

- Internal and external premises
- Controllable, semi controllable and uncontrollable premises
- Tangible and intangible premises

(a) Internal and External premises: The factors which exist within the business organisation furnish the basis for internal premises. These include sales forecast, cash flows, capital budgeting, advertising expenditure, product line, marketing mix, competence of the managerial personnel etc. On the other hand external premises are concerned with the general business climate comprising of economic, social, political, technological conditions in the economy.

(b) Controllable, semi-controllable and uncontrollable premises : The premise which can be controlled by the management are known as controllable premises, These include the internal policies, credit policies, investment plans, research projects, rules etc. which are within the jurisdiction of management. Semi-controllable premises are those over which the management has some control. Some of the examples of these premises are union management relations, firm's share in the market, market strategies, labour turnover etc. Finally premises over which a firm has no control are known as uncontrollable premises. Examples in this category include the natural calamities, wars, strike, innovations, emergency legislation etc.

(c) Tangible and intangible premises: The premises that can be expressed in tangible physical terms (monetary units) such as labour hours, production units are knows as tangible premises. On the other hand, intangible premises are those that defy quantification! Examples of intangible premises are public relations, employee morale, reputation of the firm, competitive strength of the firm, etc. though the intangible premises cannot be quantified in specific terms; these cannot be ignored while planning.

5.3.2 Organising

As an important function of management, organizing is defined as the dividing and subdividing up of duties and responsibilities which are necessary to any purpose and arranging them in groups which are assigned to individual. In the words of Koontz and O'Donnell "organizing involves the establishment of an internal structure of roles through determination and enumeration of activities required to achieve the goals of an enterprise and each part of it; the grouping of these activities, the assignment of such groups of activities to manager, the delegation of authority to carry them out, and provision for coordination of authority and informational relationships horizontally and vertically, in the organization structure".

George Terry defines organizing as "establishing the effective authority relationships among selected works, persons, and workplaces in order for the group to work together effectively". Thus, organizing function consists of dividing work among groups and individuals (division of labour) and providing for the required coordination between individual and group activities.

In the words of Louis Allen, "organizing 'is the process of identifying and grouping the work to be performed, defining and delegating responsibility and authority, and establishing relationships for the purpose of enabling the people to work most effectively together in accomplishing the objectives". In essence, organizing is the managerial function that deals with the allotment of duties, co-ordination of tasks, delegation of authority, sharing of responsibility etc.

Orientation involves the introduction of new employees to the enterprise, its functional tasks and people. Large firms usually conduct a formal orientation programmed which are conducted usually by the HR Department Orientation acts as a function of organizational socialization serving three main purposes –

(i) Acquisition of work skills and abilities

(ii) Adoption of appropriate role behavior

(iii) Adjustment to the norms and values of the work group.

Placement, on the other hand may be defined as 'determination of the job to which an accepted candidate is to be assigned, and his assignment to that job'. A proper placement is instrumental in reducing employee turnover, absenteeism and boosts employee morale.

Process of Organising:

As a function of management, i.e. as a process, organizing includes the following steps:

- Identifying the work
- Grouping the work
- Establishing formal reporting relationships
- Providing for measurement evaluation, and control
- Delegation of authority and responsibility
- Coordination,

(i) Identifying the work – The first step in the organizing process is to identify the work to be performed in the organisational unit i.e. enterprise. Every organisation is created deliberately to achieve some predetermined objectives. It is absolutely essential to identify the work to be performed to achieve the goals. Work must be divided and distributed because no one individual can perform the total work in an organisation single handed. Identification and classification of work enables managers to concentrate on important activities, avoiding the unnecessary duplications, overlapping and wastage of effort.

(ii) **Grouping the work –** Dividing work is the essence of organizing function. After making the vision, similar activities shall be grouped together in order to provide for a smooth flow of work. Departments and divisions are created in an organisation based on the principle of similarity and relatedness of the activities performed. These departments or divisions are then managed under the direction of an individual called manager of the particular department. Depending on the size of the organisation, there could be several departments for every separate function. In small organisation, various departments may be grouped together and headed by only one or a few individuals.

(iii) **Establishing formal reporting relationships –** One of the steps in organizing function is to establish formal reporting relationships among individual members in the enterprise. After establishing these formal relationships it would be possible to know the details relating to the work. Establishment of formal reporting system should pave way for assigning the duties and responsibilities to individual in an unambiguous fashion.

(iv) **Providing for measurement, evaluation and control –** Organising function involves providing the basis for measurement, evaluation and control of the activities. It should establish signposts and control points in the organisation so that the performance of individuals (and groups) can be measured evaluated, and controlled at periodical intervals. The purpose of such evaluation is to take necessary rectification measures if there are serious deviations in the actual performance.

(v) **Delegating authority –** Authority is the right to act, and extract obedience from others. A manager may not be able to perform tasks without granting authority to him by the organisation. While assigning duties the manager should clearly specify authority and responsibility limits.

(vi) **Coordination –** Individuals and groups in an organisation carry out their specialized functions and this necessitates coordination. While performing the organizing function, the manager should see that all the activities are properly coordinated and there exists 'no conflicts. Both individuals and groups may come in conflict while performing their respective duties or functions in the organisation. While organizing the functions, the manager should see that no conflicts exist among various departments and that all the departments' function as a coordinated, unified whole.

5.3.3 Staffing

Staffing is defined as the process of obtaining and maintaining the capable and competent people to fill all positions from top to operative level.

In the words of Dalton McFarland staffing is the function by which managers build an organisation through the recruitment, selection, development of individuals as capable employees.

According to Koontz and O'Donnell staffing is the executive function which involves recruitment, selection, compensating, training, promotion, retirement of subordinate managers.

Weirich define staffing as "filling and keeping filled, positions in the organization structure".

Thus, staffing is concerned with the placement, growth and development of all those members of the organization whose function is to get things done through the efforts of other individuals.

Importance of Staffing

Undoubtedly, staffing is a vital function of management more importantly because:

1. It facilitates discovery of competent and qualified people to take up various positions the organisation;

2. It enhances productivity by placing right people on the right jobs;
3. It helps in estimating the staffing requirements of the organisation in future (through manpower planning);
4. It prepares the personnel to occupy the top positions within the organisation.
5. It helps development of people through the programmes of training and development;
6. It helps the organisation to make the best use of existing workforce;
7. It ensures adequate and equitable remuneration of workforce.
8. It results in high employee morale and job satisfaction by placing the right people on right jobs;
9. It makes the top management aware of the requirements of manpower arising from transfer, promotion, turnover, retirement, death etc. of the present employees.

When the staffing function is performed effectively, the above payoffs would accrue to the organisation.

Staffing Process

Staffing process is concerned with providing the organisation with the right number of people at the right place, and at the right time so that the organisation would be able to achieve its goals effectively.

Just one wrong decision in the process would prove to be costly to the entire enterprise. A wrong placement in the organisation would adversely affect the productivity of the organisation as a whole.

Staffing process involves the following steps.

(i) Manpower Planning – Also known as human resource planning, the manpower planning is "a process of determining and assuring that the organisation will have an adequate number of qualified persons, available at the proper times, performing jobs which meet the needs of the entire enterprise and which provide satisfaction for the individuals involved" (Dale S. Beach).

Manpower planning consists of the following steps:-

(a) Determination of the organisational objectives;

(b) Determination of the skills and expertise required to achieve the organisational objectives;

(c) Estimating the additional human resource requirements in the light of the organisation's current human resources;

(d) Development of action plans to meet the anticipated human resource needs.

The main points in human resource planning are: current assessment, future assessment of the human resource needs and the development of future programme as well as career development.

(ii) Recruitment – Recruitment involves seeking and attracting a pool of people from which qualified candidates for job vacancies can be selected. Development and maintenance of adequate manpower resources is the main task of recruitment. According to Dale Yoder, recruitment is "the process of discovering the sources of manpower to meet the requirements of staffing schedule and to employ effective measures for attracting the manpower in adequate numbers to facilitate effective selection of an efficient working force".

(iii) Selection – It is probably the most critical step in the staffing process as it involves choosing candidates who best meet the qualifications and requirements of the job.

(iv) Training – It is the process of increasing the knowledge and skills of an employee for doing a particular job. The objective of training is to achieve a change in the behaviour of those trained.

(v) Placement & Induction – Placement refers to assigning rank and responsibility to an individual, identifying him with a particular job. If the person adjusts to the job and continues to perform per expectations, it means that the candidate is properly placed. However, if the candidate is seen to have problems in adjusting himself to the job, the supervisor must find out whether the person is properly placed as per the latter's aptitude and potential.

Induction refers to the introduction of a person to the job and the organisation. The purpose is to make the employee feel at home and develop a sense of pride in the organisation and commitment to the job. Proper induction would enable the employee to get off to a good start and to develop his overall effectiveness on the job and enhance his potential.

Sources of Recruitment

The important sources of recruitment are internal and external sources.

(A) Internal Sources:- The internal sources include the employees on the payroll. People from within are generally upgraded whenever any vacancy arises. By reviewing the personnel records and skills the manager would be in a position to know the suitable candidates for the vacant position. Transfers, promotions of present employees are the basic internal sources of recruitment. Further, inside moonlighting and employee's friends and relatives are also given a chance to serve the organisation, if any new vacancy arises. The internal sources of recruitment have the following merits:

- Recruitment from within encourages the employees to work efficiently to reach top positions;
- The organisations would be able to choose the right people for the vacant positions on the basis of the track records of the employees;
- Employees need little training as they know the major operations and functions of the organisation;
- The expenditure is relatively less when compared to external sources of recruitment;
- Internal recruitment improves the morale of the employees as they are sure that they would be preferred over the outsiders for higher positions.

The internal sources of recruitment have the following limitations:

- In the long run it is not a healthy sign for the organisation to rely on the existing employees. It discourages new blood from entering into the organisation. The organisation may be deprived of young talent that flows into the industry.

  The internal sources of recruitment promote sycophancy and favoritism. Workers may be recruited not because of their suitability for the jobs but because they may maintain good relations with the top management.
- The skills of existing employees may become obsolete and the organisation may have to resort the external recruitment inevitably.
- One universally accepted disadvantage of internal recruitment is the Peter Principle which states that people are promoted until they finally reach to the level of incompetence.

(B) External Sources:

Normally recruitment from external sources would be done when either the existing employees are inadequate to occupy the vacant positions or they are not properly qualified and skilled enough to occupy the positions, or they are unfit (either by virtue of their age or specialization.

The important external sources of recruitment include —

1. **Employment exchanges –** Employment exchanges run by government are regarded as a potential source of recruitment especially for unskilled, semiskilled and skilled operative jobs.

2. **Advertisement –** Advertisement in newspapers or trade and professional journals is another popular source of recruitment especially for the senior positions to lower-middle level positions.

3. **Educational Institutions –** Recruitment through educational institutions is also known as campus recruitment.

4. **Employee walk-ins –** It is commonly found that some people send unsolicited applications to the organisations enjoying goodwill and reputation. Organisation, if they find necessary, can consider these applicants for the suitable positions.

5. **Employee referrals –** Some organisations prefer using employees as the source of recruitment.

   They maintain informal system of recruitment where word-of-mouth would do when compared to formal system of organisation.

6. **Miscellaneous –** Among other methods of recruitment, 'gate hiring' is the most popular one in which people are hired at the factory gate itself.

The external sources of recruitment offer the following merits:

(i) Organisations can choose from wider spectrum under the external source of recruitment. The number of applicants would be very large and the organisation can choose the better candidates carefully after weighing the pros and cons of all the candidates.

(ii) Organisations can avoid bias to some personnel by following the external sources of recruitment objectively. Here, there is no scope for subjective judgment and selection of the candidates.

Some of the limitations of the external sources of recruitment include:

(i) Personnel chosen from external sources may cause dissatisfaction among the existing employees. It would be demoralizing to the existing employees when they come to know that organizations are considering the outsiders for filling up the top positions.

(ii) External sources of recruitment is quite costly to the enterprise. Firms have to spend heavily on advertisements and sometimes the response from the potential candidates may be dismal and disappointing. It is customary to pay (to and fro) the expenses of the candidates for attending interviews and a substantial part of it is a mere waste of resources.

Selection

Perhaps the most crucial stage in staffing process is the selection. Selection is very crucial because any errors in selection may prove to be costly to the organisation itself. This explains the reason why selection has occupied a place of prominence in the management literature.

Selection is a process of rejection and hence it is called a negative process. It divides the people into two categories viz. those who would be selected and those who would be rejected. A manager should exercise special skill in selecting the candidates.

The process of selecting the candidates for employment in organisations is a long-process. It consists of the following steps:

1. **Application blank –** Every candidate is required to fill up a blank application which provides a written record of the candidate's qualifications, etc. It is a traditional widely accepted device for eliciting information from the prospective applicants to enable the management to make proper selection of the candidates. An application

blank is a personal history questionnaire.

2. **Preliminary interview –** To eliminate the unsuitable candidates in the very beginning preliminary interviews of brief duration are conducted. A majority of the applicants would be rejected in this stage. If the applicant is eliminated at this very stage, organisation would be saving from the expenses of processing the candidate further. Even the unsuitable candidate would save himself from the trouble of passing through the long selection procedure.

3. **Employment tests –** To match the individual's mental and physical characteristics with the job appropriately, employment tests are essential. Here, intelligent tests, aptitude tests, proficiency tests, personality tests, and tests of interests and hobbies etc. are included. These days' psychological tests occupy the place of prominence in these employment tests.

4. **Final interviews –** An evaluation interview is perhaps the most crucial step in the selection process. A careful assessment of the candidate is made in the personal interview with the candidate. The purpose of conducting the employment interviews is to assess the candidate's strengths and weaknesses for the position. Apart from finding out the suitability of the candidate, the face- to-face interview also provides an opportunity to the interviewer to know more about the candidate. At the same time, the candidate would also be in a position to know about the terms and conditions of his employment, organisational policies and the employer-employee relations etc.

5. **Background Investigation –** Normally, in every curriculum, vitae (bio-data) the candidate is asked to mention the name of references. A referee is potentiality an important source of information about the stability, integrity, and personality of the candidate. Before a candidate is finally selected, organisations prefer to contact the references or dig up into the candidate's past history, past employment, financial condition, police record, personal reputation etc. which will be helpful in verifying the candidature of the person.

6. **Medical examination –** The pre-employment physical examination in terms of medical test of a candidate is an important step in the selection process. This examination isolates the medically unfit people from the rest.

7. **Final selection and placement –** If a candidate has cleared all minor hurdles in the selection procedure he is formally appointed and letter appointment is given to that effect. In the letter of appointment will be stated the terms and conditions of employment (such as pay scale, period of probation, starting salary, allowance and other perquisites, etc.)

Training and Development

One of the important managerial activities in modern organisation is the training and development programmes. It is common that organisation first recruits and select the employees and provide them some of training to increase their versatility, knowledge, adaptability skills so that the jobs they perform becomes appreciable. Training is the systematic acquisition of knowledge, skills, rules, and attitudes that have specific or narrow applicability to a limited set of situations in a specific job environment.

Training constitutes significant part of organisation's investment in human resources. Edwin Flippo contends that 'training is an act of increasing the knowledge and skill of an employee for doing a particular job':

Every training programme is aimed at fulfilling the following purposes.

1. to increase the productivity of workforce;
2. to improve the quality lot products being manufactured;
3. to help an organisation to fulfill its future personnel needs;
5. to improve the health of workers;

6. to promote the safety of workers on the job;
7. to prevent the obsolescence of employees at work;
8. to maintain personal growth of employees in the enterprise;
9. to improve overall organisational climate. According to O. Jeff Harris "Training of any kind should have as its objective the redirection or improvement of behaviour so that the performance of the trainee becomes more useful and production for himself and for the organisation of which he is a part. Training normally concentrates on the improvement of either operative skills interpersonal skills, or decision making skills, or a combination of all these skills".

Operative skills are required for the successful completion of a given task. Interpersonal skills are related to the maintenance of successful relationship between peers and subordinates. Finally, decision making skills are related to the problem identification and prescribing an appropriate solution.

Methods of Training

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

Merits of on-the-job training – Some of the payoffs of on-the-job training are listed as under:-

1. One of the biggest advantages of on-the-job training is that trainee learns on actual working environment rather than on artificial environment.
2. The trainee observes the rules, regulations, and systems being followed in day-today organizational life.
3. Additional personnel are not required for training the employees when on-the-job method of training is used. Therefore, there is an advantage of economy by using this method.

Demerits of on-the-job training – On-the-job training suffers from the following demerits:-

1. The trainee may learn in a haphazard manner. Since there is no direction under which the trainee learns while performing job, there would be disorganized learning on the part of the trainee.
2. Sometimes, inexperienced handling of machines and tools by the trainees may result in colossal losses to the organisation. For example, if an employee is asked to work on an 'Apple' computer, just by giving a few directions to operate the computer, it is quite likely that the machine would go out of order within no

time. This would be costly to the enterprise as such.

3. The productivity of employees who is undergoing training on-the-job would be dismal and disappointing. Further it affects the flow of work when the production undergoes different processes.
4. Sometimes it becomes very difficult for the trainee to work as well as learn. In spite of these limitations, on-the-job training is considered suitable to supervisors, operatives, and lower-level executives.

(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)

Merits of Off-the-Job Training

1. This type of training gets employees away from their work environment to a place where their frustrations and bustle of work are eliminated. This more relaxed environment can help employees to absorb more information as they feel less under pressure to perform.
2. Can be a source to supply the latest information, current trends, skills and techniques for example current employment legislation or other company law and regulations, current computer software or computerized technologies or improved/innovative administrative procedures. These new skills can be brought back and utilized within the company.
3. Experts in their field would cover these courses, and this would mean that training for staff members would be taught to a reasonable standard.
4. As the courses are held externally, our company would not have added costs incurred as a result of extra equipment or additional space.
5. Sending an employee on a course could help to make an employee feel more valued as they would feel as if they are receiving quality training.
6. As many courses or seminars invite employees from other companies to attend, this would allow employees to network and perhaps drum-up business.

Demerits of Off-the-Job Training

1. Depending on the course, the overall cost could prove quite expensive for example; many courses may require an overnight stay at a hotel if the course is outside the area or the course itself may prove to be expensive due to the level of expertise or equipment need to deliver the course.
2. As there is no real way to know the abilities both as a trainer and their subject knowledge of the people delivering the external training courses, there is no guarantee that sufficient skills of knowledge will be transfers or valuable.
3. The different learning speeds of individuals who are usually forced to progress at a compromise rate.
4. Not all the learners will be starting at the same knowledge or skill level and there is a risk that those starting at

the lowest levels, if account is not taken of this, will be lost from the start.

Placement, Orientation and Induction

After a candidate is selected for a particular job in an organisation what needs to be done in staffing process is to induct him in his new job. Placement and induction represents the last stage in the staffing process. Orientation involves the introduction of new employees to the enterprise, its functional tasks and people. Large firms usually conduct a formal orientation programme which is conducted usually by the HR Department. Orientation acts as a function of organizational socialization serving three main purposes:

(i) acquisition of work skills and abilities,

(ii) adoption of appropriate role behavior

(iii) adjustment to the norms and values of the work group.

Placement, on the other hand may be defined as 'determination of the job to which an accepted candidate is to be assigned, and his assignment to that job. A proper placement is instrumental in reducing employee turnover, absenteeism and boosts employee morale. Here, the selected candidate is given a copy of the policies, procedures and rules and regulations of the enterprise in question. The candidate will be given a complete and unambiguous description of the nature of job assigned to him, to whom he is accountable, who are accountable to him etc. Thus, the employee will come to know the exact authority-responsibility-accountability relationships.

5.3.4 Leading

Leading is another of the basic function within the management process "Leading is the use of influence to motivate employees to achieve organizational goals" – Richard Daft. Managers must be able to make employees want to participate in achieving an organization's goals. Three components make up the leading functions:

- Motivating employees
- Influencing employees
- Forming effective groups.

The leading process helps the organization move toward goal attainment.

Leading involves the social and informal sources of influence that you use to inspire action taken by others. If managers are effective leaders, their subordinates will be enthusiastic about exerting effort to attain organizational objectives.

The behavioral sciences have made many contributions to understanding this function of management. Personality research and studies of job attitudes provide important information as to how managers can most effectively lead subordinates. To become effective at leading, managers must first understand their subordinates' personalities, values, attitudes, and emotions.

Studies of motivation and motivation theory provide important information about the ways in which workers can be energized to put forth productive effort. Studies of communication provide direction as to how managers can effectively and persuasively communicate.

Studies of leadership and leadership style provide information regarding questions, such as, "What makes a manager a good leader?" and

"In what situations are certain leadership styles most appropriate and effective?"

Communication, Coordination, Collaboration, Monitoring and Control

5.4

5.4.1. Communication

The term communication is derived from the Latin word 'communis' which means "common". The word communication stands-for the sharing of ideas in common. Communication of ideas establishes a common ground for understanding the people in organisations. Communication is vital to all managerial actions. Communication is the artery of an organisation through which the decisions and instructions of the management flow down to the lowest levels. It also conducts upward the pulse of workforce in organisations. Communication is a process of passing information and understanding from one person to another.

- According to Dalton McFarland "communication is the process of meaningful interaction among human beings. More specifically, it is the process by which meanings are perceived and understandings are reached among human beings".
- Herbert A. Simon contends that communication is the "process whereby decisional premises are transmitted from one member of an organisation to another".
- In the words of Newman and Summer, "Communication is an exchange of facts, ideas, opinions or emotions by two or more persons.
- Louis A. Allen, a well-known management expert, defines communication as the "sum of all the things one person does when he wants to create understanding in the mind of another. It is a bridge of meaning. It involves a systematic and continuous process of telling, listening and understanding".

Simply, communication is the act of making one's ideas and opinions known to others.

Importance of Communication

Communication is very important because it is a process by which the managerial functions of planning, organising, directing and controlling are accomplished. Without formal system of communication it is not possible for an organisation to exist. Secondly, communication is an activity to which the manager devotes an overwhelming proportion of his precious time. The importance of communication in organisations is summed up by Keith Davis in the following words: "Just as a man gets arteriosclerosis, a hardening of the arteries which impairs his efficiency, so an may organisation get info sclerosis, a hardening of the communication arteries, which produces similar impaired efficiency". Communication is important because;

- In organisations, communication ties people and structure together.
- Communication is a bridge of meaning between two or more people.
- Communication involves understanding and acceptance of ideas to act in it.
- Effective communication is a substance of good management; communication is not a substitute for good management.

Communication Process

The basic elements in the communication process are:

1. **The Communicator or Sender –** The process of communication starts with the communicator. In an organisation, communicators can be managers, non-managers, departments, the outside public, customers etc. Without communication, an organisation cannot function. The communicator has a message, or an idea or information to be communicated.

2. **Encoding –** The second important element in the communication process is encoding. Encoding involves the selection of language in which the message is to be given. The medium of expression may be speaking, writing, signaling, gesturing, physical contacting, handshake, hitting etc. Encoding should be done in such a way that the receiver may correctly understand the message communicated to him.

3. **Message –** The message is what a communicator is communicating. Without this, there is no communication. The message sent by the person should be stated in clear and [unambiguous terms. Managers have several purposes of communicating viz. to have others understand their ideas, to understand the ideas of others, to gain the acceptance of their ideas, and finally to produce action.

4. **Medium –** The medium is said to be the carrier of message sent by a person to another. The medium may be face-to-face communication, telephone, group meetings, computers, memorandums, policy statements, production schedules, and sales forecasts. Sometimes, nonverbal media such as facial expressions, body language, tone of voice, gesturing etc., are also used. Thus, the transmission of message may be done orally, in writing, or by gesturing.

5. **Decoding –** It involves interpretation of the message by the receiver. Interpretation of message largely depends on the perception, past experience and attitudes of the receiver.

6. **The receiver –** A communicator has to communicate with some other person called, the receiver. While communicating, the person should carefully understand the receiver. The communicator should take into account the receiver, his decoding abilities, his understanding capacity of the message being transmitted. Effective communication is always receiver-oriented; not message oriented. The communicator should see that the receiver receives the message accurately and properly. If the receiver is unable to receive the message, the fault lies in the communicator, not the receiver. The communicator should send the message in that language which the receiver understands.

7. **Feedback –** Communication process includes feedback also. Feedback is an essential to see that no distortion between the intended message and received message exists.

8. **Noise –** It is a disturbance that tends to obstruct the smooth flow of communication and reduces the clarity of the message. It may be the result of poor network, in attention of the receiver etc.

Types of Organisational Communication

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.

Barriers to Communication

Although a communicator may take great care in sending the message to the receiver properly, there may exist some barriers to communication. A poorly transmitted message often leads to misunderstanding. This would pave way to strained relations and frictions among the employees. This detrimentally affects morale of the employees. Some of the barriers to communication are —

(i) Filtering: The information may be filtered by sender deliberately to mislead the receiver. A manager filters the information by hiding some meaning and disclosing in such a fashion that the information is appealing to the employee. When the sender tries to filter the information, he is said to alter the communication in his favour at the cost of the real message. Filtering the message is a powerful barrier to communication.

(ii) Selective perception: This time the fault lies in the receiver who may indulge in selective perception. The receiver may like to perceive in what he is interested. Perceptual selection may sometimes lead to perceptual distortion. Perpetual distortions and fallacies may become endemic and vitiate the entire system. This affects the organisational effectiveness adversely.

(iii) Language: Communication is said to be poor and distorted if the message is not properly expressed. When information is worded in a manner not understandable to the receiver it is quite likely that the message may be misunderstood. Further, semantic problems may also distort the message.

(iv) Semantic Barrier: The language, words, symbols and expressions used in communication may distract attention from the actual meaning of the message. Moreover, the tendency of people to interpret the same message in different ways may also act as a semantic barrier.

(v) Emotions: Emotions of both the sender and receiver influence the message that is transmitted and received. The receiver is likely to take into account the emotion of the sender and interpret the information accordingly. Extreme emotions and jubilation or depression have probability of hindering the effectiveness of communication.

(vi) Information overload: When managers furnish the heavy information to subordinates, they become unable to distinguish between important and unimportant and this way the entire exercise of communicating would be redundant and wasteful.

(vii)Non-verbal cues: They are very important sources of hindering the message especially when these cues are inconsistent with the message. Normally, the receiver expects some consistency in the non-verbal cues with the message being transmitted.

(viii)Time Pressures: Often in organization the targets have to be achieved within a specified time period, the failure of which has adverse consequences. In a haste to meet deadlines, the formal channels of communication are shortened, or messages are partially given, thus hampering effective communication.

Effective Communication

In order to make communication effective it is absolutely essential for the managers to overcome the barriers. The following are the ways to overcome the barriers:

- Fostering interpersonal trust
- regulate the flow of information

- have feedback, both verbal and non-verbal
- simplifying language
- effective listening
- see the emotions do not cloud and distort the message
- understand the non-verbal cues.

5.4.2. Coordination

Coordination is the effort to ensure a smooth interplay of the functions and forces of all the different component parts of an organisation so that its purpose will be realised with a minimum of friction and a maximum of collaborative effectiveness. "It makes diverse elements and sub- systems of an organisation to work harmoniously towards the realisation of common objectives". "Coordination is the process whereby an executive develops an orderly pattern of group effort among his subordinates and secures unity of action in the pursuit of common purpose".

Coordination is a conscious and rational process of pulling together the different parts of an organization and unifying them into a team to achieve predetermined goals in an effective manner.

According to Henry Fayol, 'To coordinate is to harmonise all the activities of a concern so as to facilitate its working and its success. In a well-co ordinated enterprise, each department or division works in harmony with others and is fully informed of its role in the organisation. The working schedules of various departments are constantly tuned to circumstances." Coordination is the orderly synchronization of efforts of the subordinates to provide the proper amount, timing and quality of execution so that their unified efforts lead to the stated objective, namely the common purpose of the enterprise. It involves blending the activities of different individuals and groups for the achievement of common objectives.

George Terry and Theo Haimann consider coordination as a permeating function of management passing through the managerial functions of planning, organising, staffing, leading and controlling.

Thus, according to them, co-ordination is not a separate function of management as it transverses the entire process of managing - it is thus the essence of management.

Features of Co-ordination

(i) Coordination is not a distinct function but the very essence of management. It is inherent in managerial job and embodied in all the functions of management.

(ii) Coordination is the basic responsibility of management and it can be achieved through the managerial functions. No manager can evade or avoid this responsibility.

(iii) Coordination does not arise spontaneously or by force. It is the result of conscious and concerted action by management. It cannot be left to chance.

(iv) The heart of coordination is the unity of purpose which involves fixing the time and manner of performing various activities,

(v) Coordination is a continuous or on-going process. It is also a dynamic process involving give and take.

(vi) Coordination is required in group efforts, not in individual effort. It involves the orderly arrangement of group efforts. There is no need for coordination when an individual works in isolation without affecting anyone's functioning.

(vii) Coordination is a systems concept in the sense that it regards an organisation as a system of cooperative efforts. It recognises the diversity and interdependence of organisational systems and the need for fusion and synthesis of efforts.

Principles of Coordination

Principles for achieving effective coordination can be enumerated as below:

1. **Principle of Early Stage -** According to this principle, coordination must start at an early stage in the management process. It must start during the planning stage. This will result in making the best plans and implementing these plans with success.

2. **Principle of Continuity -** According to this principle, coordination must be a continuous process. It must not be a one-time activity. The process of coordination must begin when the organisation starts, and it must continue until the organisation exists.

3. **Principle of Direct Contact -** According to this principle, all managers must have a Direct Contact with their subordinates. This will result in good relations between the manager and their subordinates. This is because direct contact helps to avoid misunderstandings, misinterpretations and disputes between managers and subordinates.

4. **Principle of Reciprocal Relations -** The decisions and actions of all the people (i.e. of all managers and employees) and departments of the organisation are inter-related. So, the decisions and actions of one person or department will affect all other persons and departments in the organisation. Therefore, before taking any decision or action all managers must first find out the effect of that decision or action on other persons and departments in the organisation. This is called the Principle of Reciprocal Relations. Co-ordination will be successful only if this principle is followed properly.

5. **Principle of Effective Communication -** Co-ordination will be successful only in the presence of an effective communication. Good communication must be present between all departments, within employees themselves and even between managers and their subordinates.

6. **Principle of Clarity of Objectives -** Co-ordination will be successful only if the organisation has set its clear objectives. Everyone in the organisation must know the objectives very clearly. No one must have any doubts about the objectives of the organisation. Clear objectives can be achieved easily and quickly.

5.4.3 Collaboration

Collaboration is a concept and method by which teams can work together very successfully. Bringing together a team of experts from across the business would seem to be a best practice in any situation.

However, Gratton and Erickson, in their article Eight Ways to Build Collaborative Teams, found that collaboration seems to decrease sharply when a team is working on complex project initiatives. In their study, they examined 55 larger teams and identified those with strong collaboration skills, despite the level of complexity. There were eight success factors for having strong collaboration skills:

- "Signature" relationship practices
- Role models of collaboration among executives
- Establishment of "gift" culture, in which managers mentor employees
- Training in relationship skills
- A sense of community
- Ambidextrous leaders—good at task and people leadership
- Good use of heritage relationships
- Role clarity and talk ambiguity

As teams grow in size and complexity, the standard practices that worked well with small teams don't work anymore. Organizations need to think about how to make collaboration work, and they should leverage the above best practices to build relationships and trust.

Different modes of collaboration involve different strategic trade-offs. Companies that choose the wrong mode risk falling behind in the relentless race to develop new technologies, designs, products, and services. In this context the issue of collaborative architecture has paramount significance which align firms structure with organizing principles. To help senior managers make better decisions about the kinds of collaboration their companies adopt, Gary P. Pisano and Roberto Verganti had proposed a relatively simple framework which was published in Harvard Business Review, December, 2008 ("Which Kind of Collaboration Is Right for You?").The framework rests on two questions-

- Given your strategy, how open or closed should your firm's network of collaborators be?
- And who should decide which problems the network will tackle and which solutions will be adopted?

According to them Collaboration networks differ significantly in the degree to which membership is open to anyone who wants to join. In totally open collaboration, or crowdsourcing, everyone (suppliers, customers, designers, research institutions, inventors, students, hobbyists, and even competitors) can participate.

Collaboration networks also differ fundamentally in their form of governance. In some the power to decide which problems are most important, how they'll be solved, what constitutes an acceptable solution, and which solutions should be implemented is completely vested in one firm in the network: the "kingpin." Such networks are hierarchical. Other networks are flat: The players are equal partners in the process and share the power to decide key issues.

There are four basic modes of collaboration:

- a closed and hierarchical network (an elite circle),
- an open and hierarchical network (an innovation mall),
- an open and flat network (an innovation community), and
- a closed and flat network (a consortium).

Innovation Mall A place where a company can post a problem, anyone can propose solutions, and the company chooses the solutions it likes best **Example:** InnoCentive.com website, where companies can post scientific problems	**Innovation Community** A network where anybody can propose problems, offer solutions, and decide which solutions to use **Example:** Linux open-source software community	**PARTICIPATION**	**Open**
Elite Circle A select group of participants chosen by a company that also defines the problem and picks the solutions **Example:** Alessi's handpicked group of 200-plus design experts, who develop new concepts for home products	**Consortium** A private group of participants that jointly select problems, decide how to conduct work, and choose solutions **Example:**IBM's partnerships with select companies to jointly develop semiconductor technologies		**Closed**
GOVERNANCE			
Hierarchical	**Flat**		

Source:- Gary P. Pisano and Roberto Verganti, HBR, December, 2008

How to Choose the Best Mode of Collaboration

When selecting a mode of collaborative innovation, executives need to consider the distinct strategic trade-offs of each mode. Below are some important advantages and challenges of the different approaches to collaboration, and examples of capabilities, assets, processes, and kinds of problems that make each easier to carry out. Pisano and Verganti had discussed the merits and demerits of these four modes of collaboration in juxtaposition.

PARTICIPATION	GOVERNANCE: Hierarchical	GOVERNANCE: Flat	
Open	Innovation Mall	Innovation Community	**Advantage:** You receive a large number of solutions from domains that might be beyond your realm of experience or knowledge, and usually get a broader range of interesting ideas. **Challenge:** Attracting several ideas from a variety of domains and screening them. **Enablers:** The capability to test and screen solutions at low cost; information platforms that allow parties to constibute easily; small problems that can be solved with simple design tools, or large problems that can be broken into discrete parts .
Closed	Elite Circle	Consortium	**Advantage:** You control the direction of innovation and who captures the value from it. **Challenge:** Choosing the right direction. **Enablers:** The capability to understand user needs; the capability to design systems so that work can be divided among outsiders and then integrated.
	Advantage: You control the direction of innovation and who captures the value from it. **Challenge:** Choosing the right direction. **Enablers:** The capability to understand user needs; the capability to design systems so that work can be divided among outsiders and then integrated.	**Advantage:** You share the burden of innovation. **Challenge:** Getting contributors to converge on a solution that will be profitable to you. **Enablers:** Processes and rules that drive parties to work in concert to achieve common goals.	

Source:- Gary P. Pisano and Roberto Verganti, HBR, December, 2008

5.4.4. Monitoring

Monitoring is the systematic process of collecting, analyzing and using information to track a programme's progress toward reaching its objectives and to guide management decisions. Monitoring is really helpful for ensuring that the objectives of the activity or project or business is achieved as per target. Gosling and Edwards (2003) defined monitoring as "systematic and continuous collecting and analysing of information about the progress of a piece of work over time". Monitoring is done to ensure that all the people who need to know about a development intervention are properly informed about it. It is also done so that management decisions can be taken in a timely manner.

Traditionally, monitoring differs from evaluation because it is carried out by internal rather than external staff, it is ongoing rather than periodic, and it focuses more on activities and outputs than on outcomes and impact. In addition, monitoring usually relies on a system, rather than being a one-off exercise carried out a specific point in time.

Significance of Monitoring:-

a. Monitoring results in better transparency and accountability

b. Monitoring helps organizations to detect problems early

c. Monitoring ensures resources are used efficiently

d. It helps organizations learn from their mistakes

e. Monitoring improves decision making

f. It helps organization to stay organized

g. Monitoring helps organizations replicate the best projects/programs

h. It encourages diversity of thought and opinions

However, depending on its application purposes of monitoring may take various dimensions. In different circumstances, monitoring can also serve several other purposes. Some of the more common are:

- providing managers, staff and other stakeholders with information on the progress being made towards stated goals and objectives in order to demonstrate accountability to different stakeholders;
- providing information that enables approaches and strategies to be changed in response to evolving situations;
- identifying whether there is a need to change goals, objectives, plans or budgets over time;
- testing project or programme assumptions on a regular basis;
- identifying the need for further information or research;
- providing information that enhances ongoing learning, both within and outside a project or programme; and
- demonstrating or communicating activities and changes to other audiences for marketing or fundraising purposes.

Types of Monitoring

There are many different types of monitoring. Some of the most common types are described below. However, these are known by different names in different organisations.

- **Process or performance monitoring:-** It focuses on the activities carried out as part of a development intervention. It is designed to assess whether and/or how well those activities are being implemented. It also covers the use of resources. Process monitoring is designed to provide the information needed to continually plan and review work, assess the success or otherwise of the implementation of projects and programmes, identify and deal with problems and challenges, and take advantage of opportunities as they arise.

- **Results or impact monitoring:-** It aims to assess the changes brought about by a project or programme on a continuous basis. Often this means assessing changes in a target population (e.g. individuals, communities, supported organisations, targeted decision-makers). Impact monitoring can be used to assess progress towards goals and objectives, as well as unintended change. Despite the name, impact monitoring is more often associated with changes at outcome, rather than impact, level.
- **Beneficiary monitoring :-** It is a specific type of impact monitoring that aims to track the perceptions of project or programme beneficiaries (IFRC 2011). It can include beneficiary feedback mechanisms and beneficiary complaints mechanisms.
- **Situation monitoring :-** It is concerned with monitoring the external environment. Sometimes this is done through defining and collecting indicators relating to issues such as the local political situation, changes in the economy, and the activities of other development actors. At other times, situation monitoring simply means keeping eyes and ears open in order to assess what is happening outside of a project or programme that might influence it.
- **Financial monitoring:-** It is concerned with the monitoring of budgets and finance, and is linked to auditing. It is usually concerned with tracking costs against defined categories of expenditure.
- **Administrative or logistics monitoring:-** It covers issues such as the maintenance of premises, transport, personnel, stock-keeping, and other forms of administration.
- **Compliance monitoring :-** It is designed to ensure compliance with issues such as legal regulations, grant or contract requirements, government regulations, and ethical standards.

Steps of Monitoring Process: - Based on the types of monitoring steps of monitoring process may differ significantly. However, common steps of monitoring process are as follows-

- **Planning:-** information generated through monitoring can result in changed plans immediately, whereas evaluation only feeds into changed plans at periodic intervals. Both process and impact monitoring may involve assessing unexpected change, but they are also closely concerned with monitoring progress against pre-planned objectives, activities, indicators, milestones and targets. Process monitoring is often associated with short-term plans dealing with activities. These can include annual, quarterly, monthly and weekly activity plans, often with associated budgets. The purpose of much monitoring is to ensure that plans are being delivered as expected, and to take appropriate action where they are not.
- **Collecting information:-** Sometimes information is collected through formal tools such as semi-structured interviews, structured observation and focus group discussions. A lot of monitoring also involves the routine collection and recording of numeric data on predefined templates. During monitoring, information is routinely collected on pre-defined objectives and indicators, or activities described in activity plans. However, information can also be collected on activities and changes that were not anticipated, or changes in the wider environment that might affect a project or programme.
- **Recording information:-** Some monitoring information can be acted on immediately. For example, if there is low attendance at community meetings in the morning then meetings can be switched to the afternoon. Often, however, monitoring information needs to be recorded so that it can be stored, shared, analysed, reported or used at a later date. Another form of recording covers the production of minutes or descriptions of meetings attended by different stakeholders. Meeting minutes can be used to ensure that everyone has the same understanding of the points raised, or agreements made.

- **Storing information:** Some monitoring systems can result in a very large amount of information being collected and recorded. This information needs to be stored appropriately so that it can be retrieved and used for different purposes as and when necessary. The type of storage system depends heavily on the type of information collected.
- **Analysing information:** Analysis processes range from producing tables and graphs that summarise statistical information through to generating lessons and trends from large amounts of qualitative data. Many simple monitoring tools are designed to enable basic data analysis. For example, Gannt charts or other simple monitoring charts are designed to track project and programme activities over time, and compare this with planned or predicted progress.
- **Sharing information:** Monitoring data, once collected, recorded, stored and analysed, often needs to be shared with different stakeholders if it is to be useful. These stakeholders may include staff or managers within a project or programme, beneficiaries, partners, donors, or any other kind of stakeholder. It is important to know who needs (or would like) which information, when and where. Otherwise there is a risk of people become overwhelmed with information that they do not need and cannot use.
- **Reporting information:** Reporting information is just one way of sharing information through both internal as well as external mechanisms like published reports, circulars and electronic disclosures.
- **Using information:** Monitoring information can be used in many ways. The key purpose is to make changes, where necessary, to plans, budgets or targets, or to modify working approaches, especially when projects and programmes are operating in difficult or constantly changing environments.

Monitoring data can help firms be accountable to their own partners, communities and beneficiaries, as well as donors and supporters. Monitoring data may also support institutional learning, contribute to marketing and public relations, provide evidence for advocacy, and inform resource allocation decisions.

Finally, monitoring information gathered during a project or programme is often used during later evaluations and/ or formal reviews.

5.4.5 Control

From president to supervisor, controlling is the function that is performed utmost carefully by ever' manager. Control refers to the task of ensuring, that activities are producing the preset targets or goals.

Controlling is aimed at monitoring the outcome of activities, reviewing feedback information about this outcome, and if necessary takes corrective action. In the words of Anthony, control is "the process by which managers assure that recourses are obtained and used effectively and efficiently in the accomplishment of the organisational objectives".

According to Haynes and Massie, control is any process that guides activity toward some predetermined goal.

Hicks and Gullet content that "controlling is the process by which management sees if what did happen was what was supposed to happen. If not, necessary adjustments are made".

Koonts and O'Donnell contend that "Managerial control implies the measurement of accomplishment against the standard, and the correction of deviations to assure attainment of objectives according to plans."

Control function is closely connected to planning. In fact, control is an effective counterpart to planning. Planning and control are so entwined that it becomes almost impossible to determine where one leaves off and the other begin. Planning without corresponding controls are apt to hollow hopes.

The Control Process

A control system follows the following sequence —

(i) Establishment of Standards: The first step in control process is the establishment of standards or objectives or targets against which the actual performance is measured. Fred Lufthansa contends that "standards are used to control the objectives, objectives are used to control goals, and goals are used to control purpose". Before setting standards, managers take necessary steps such as studying the work characteristics, setting the acceptable levels of goal performance etc. Further, a manager should see that standards are not rigid, rather they are rationally flexible.

(ii) Measurement of actual performance: Another crucial step in controlling is the measurement of actual performance of employers. A manager has to measure the work against which appropriate standards are set. Measurement of performance is particularly difficult for less technical tasks.

(iii) Comparing the actual performance with standards: The comparison may reveal some deviations from the standards established. In very rare occasions only actual performance matches perfectly with the standards. While comparing the actual performance with the standards, a manager should see that the deviation does not go beyond an acceptable range.

(iv) Taking corrective action: If the actual result is far from the desired result (whether the deviation is positive or negative) corrective action- is called for. If there is a negative deviation an enquiry should be made as to why actual results were not meeting the standards. If there is positive deviation, it does not mean that the performance is very good. The positive deviation may be due to substandard being fixed. This too calls for corrective action. Standards should be revised.

A manager has to assess the causes of deviation and take necessary rectification measures. Corrective action includes —

- re-setting the standards
- reallocation of duties to employees
- changing the organisation structure
- providing motivation to employees
- Training and selecting the employees.

Controlling Responsibilities

What to Control?

In any organisation or a work unit, managers have to decide in advance the area or points of activity which need to' be controlled —these are to be selected based on their importance in relation to the whole activity and desired results. This leads us to examine two concepts: critical point control and control of exception.

(a) Critical point control: In a simple operating system, all aspects of the activity can be watched and controlled in a close manner. But as a system becomes more complex, it may not be possible or necessary or economical to control each and every aspect of the activities. In such cases controls have to be selective. A few key areas or aspects of the activity and their performance have to be identified and control attention has to be focused on them. The underlying assumption is that the selected key areas or aspects are critical to the survival and success of the system in the sense of being limiting or bottleneck factors and that by paying attention to them it is possible to ensure planned performance of the whole operation. The selected key areas for control are variously called key result areas, key success factors, critical points or strategic points. In the area of inventory control, ABC analysis is an example of critical point control.

(b) Control by exception: Also known as 'management by exception', the principle is widely practiced by managers in organizations. It means that managers at each level should pay attention to only exceptional and significant deviations from planned results. Only exceptional instances of off-line functioning of the system should deserve managerial attention and remedial action. Performance which is largely within the permissible standards in spite of the presence of minor deviations or disorders need not be referred to managerial attention. The idea behind the principle of control by exception is that 'no news is good news'. If there is nothing to report, the presumption is that the system is functioning alright.

Types of Control

Three types of control systems are used by Modern organisations, namely

(i) Historical (or) Feedback control

(ii) Concurrent control and

(iii) Predictive of feed forward control.

(i) Feedback control: In all physical and biological systems, some message is transmitted in the form of mechanical transfer of energy, a chemical reaction, or any other means which is known as 'cybernetics'. In social systems also, some information is sent back to exercise control. Any good managerial system controls itself by information feedback which discloses errors in accomplishing goals and initiates corrective action. Feed back is the process of adjusting future action based upon information about past performance. Though feedback is 'after the fact' it is vital to the control process. Sometimes, input variables are immeasurable (e.g., the values an employee brings to the job) or are not detected at the feed forward control point. Feed back is necessary in any continuous activity as it enables to take corrective action which is essential for the accomplishment of goals of the system.

The concept of feedback is important to the development of an effective control in any organisation. This is also known as 'post control' which refers to gather information about completed activity, to evaluate information and to take corrective actions to improve similar activity in future. In other words, it permits the manager to use information on past performance to bring future performance in line with planned objectives and standards. Post control helps in testing validity and appropriateness of standards. To make post-control more meaningful and effective, analysis of post-performance is required to be made as quickly as possible and control reports should have been submitted to the manager without loss of time.

(ii) Concurrent control: It is known as 'real time' or 'steering' control. It is concerned with the adjustment of performance before any major damage is done. For instance, the navigator of a ship adjusts its movements continuously or the driver of a car adjusts its steering continuously depending upon the direction of destination, obstacles and other factors. In a factory, control chart is an example of concurrent control. Concurrent control occurs while an activity is still taking place.

(iii) Feed forward control: Feed forward control involves evaluation of inputs. Feed forward follows the simple principle that an organisation is not stronger than its weakest link. For instance, if a machine is not functioning properly, the operator will look for certain critical components to see whether they are working well or not. The same logic applies to feed forward control, it is essential to determine and monitor the critical inputs into any operating system. Preventive maintenance programme is an important example of feed forward control. It is employed to prevent a breakdown in machinery. Another example of feed forward control is formulation of policies to prevent critical problem from occurring. For instance, a policy on absenteeism may be communicated to new employees to help and prevent potential problems created by absenteeism.

Prerequisites of an Effective Control System

Any control system should meet certain requirements in order to be effective, which are indicated below:

(1) There should be a match between the type of function and the system of control at all levels of the organisation.

(2) The control system should be sensitive enough to point out deviations from plans immediately so that corrective action can be initiated with little loss of time and before any damage is caused.

(3) The control system should be flexible and forward looking just like the planning system, to enable the organisation and its sub-systems to adapt and adjust their goals and the means of reaching them in turn with the change in the environment i.e., to maintain a sort of dynamic equilibrium.

(4) The control system should focus on strategic and key activity areas or points which are critical to overall performance.

(5) The control system should enable managers to utilize their time and talent most effectively by concentrating on major or exceptional deviations from plans.

(6) The control system should be formal and objective as far as possible, in fairness to those whose performance is monitored, regulated and evaluated. To some extent, quantification of performance standards meets this requirement.

(7) The control system should be consistent with the organisational structure. It should be built into the horizontal activity relationships and vertical authority relationships. In a sense, the organizational structure is a control system, designed to achieve certain pre-determined goals effectively.

(8) Controls are nothing more than means to certain ends. They are not ends in themselves. They should constantly focus on goals to be achieved, on values to be preserved and on interests to be promoted.

(9) The control system should be economical to operate; economy need not however be exercised at the cost of effectiveness. Sometimes, a simple inexpensive control system may match with expensive, highly sophisticated one in terms of effectiveness.

(10) The control system should give due allowance to factors or variables which cannot be controlled but which affect the performance of people.

(11) The control system should be designed to measure and evaluate the diverse dimensions of performance of individuals and activity areas, giving appropriate weightage to all the relevant variables having a bearing on performance: qualitative variables or factors deserve to be taken into consideration, while evaluating performance.

(12) The means adopted to achieve goals should also be kept under watch by the control system, because both means and ends are important.

(13) Finally, the control system should be understandable to those whose performance is sought to be regulated. The requirements of control should be communicated in a simple and straightforward manner to those who are to abide by the system.

Principles of Control

The following principles of control summaries the substantive parts of the above discussion on the controlling function:

1. **Principles of assurance of objective:** The task of control is to ensure that plans succeed by detecting deviations from plans and furnishing a basis for taking action to correct potential or actual deviations.

2. **Principle of future-directed controls:** The more a control system is based on feed forward rather than simple feedback of information, the more managers have the opportunity to perceive undesirable deviations from plans before they occur and to take action in time to prevent them. Control, like planning, should ideally be forward-looking, because of time lags in the system of information feedback. Hence control should be directed towards the future by devising proper information, forecasting, early warning and rapid response mechanisms.

3. **Principle of control responsibility:** The primary responsibility for the exercise of control rests in the manager charged with performance of the particular plans involved. There is unity of planning and control in each managerial position.

4. **Principle of efficiency of control:** Control techniques and approaches are efficient if they detect and illuminate the nature and causes of deviations from plans with a minimum of costs or other unsought consequences. The results of control should be worth their costs—both in monetary and human terms. The adverse human consequences of control have especially to be guarded against.

5. **Principle of direct control:** Higher the quality of every manager in a managerial system, they would ensure a high quality of managerial decision making and action behaviour.

6. **Principle of reflection of plans:** The more the plans are clear, complete and integrated, and the more the controls are designed to reflect such plans, the more effectively controls will serve the needs of managers. Clear, complete and integrated plans facilitate better control.

7. **Principle of organisational suitability:** The more that an organisational structure is clear, complete and integrated, and the more that controls are designed to reflect the place in the organization structure where responsibility for action lies, the more they will facilitate correction of deviations from plans. Responsibility for execution of plans and for correction of deviations must be pinpointed clearly in the organisational structure.

8. **Principle of individuality of control:** The more that control techniques and information are understandable to individual managers who must utilise them for results, the more they will be actually used and the more they will result in effective control. Control techniques should be tailored to the personality and orientations of managers; at least they should be intelligible to them and within their power of understanding.

9. **Principle of standards:** Effective controls require objective, accurate and suitable standards. Measurement of performance by reference to standards should be verifiable, specific and simple. Standards should earn the respect of people who have to abide by them.

10. **Principle of critical point control:** Effective control requires attention to those factors critical to appraising performance against an individual plan. Managers should concentrate on salient features of performance in selective areas, picked up as of strategic importance.

11. **Principle of exception:** The more managers concentrate control efforts on exceptions, the more efficient will be the results of their control. This principle suggests that managers should concentrate on significant deviations, both positive and negative, from plans.

12. **Principle of flexibility of control:** If controls are to remain effective, despite failure or unforeseen changes of plans, flexibility is required in their design. Since plans have to be flexible to order to be effective, control has also to be flexible.

13. **Principle of action:** Control is justified only if indicated or experienced deviations from plans are corrected through appropriate planning, organising, staffing and leading. The principle affirms the essential unity of management.

Techniques of Control

Managers use different methods and systems to exercise control of different levels. Now, we will touch upon some of the tools and mechanisms devised by managers and others, over the years to control specific aspects of activity and performance of an enterprise or work units.

1. **Budgetary Control:** "Budgets are formal quantitative statements of the resources allocated for the execution of activities over a given period of time, and include information about projected income, expenditure and profits." Budgets are useful as tools of control to the extent that they, permit, monitoring, measurement, evaluation, regulation and correction of enterprise activity along desired pre determinate directions.

   The essential elements of budgetary control are outlined as follows:

   (i) Translation of enterprise goals into sub goals of the various operating units which are further operationalised as standards of performance, and targets of achievement (sales, market share, production, profit etc.), over a short period of time say, six months or one year.

   (ii) Determination of the volume of resources required to achieve the operational goals - funds, material, labour, equipment, time and so forth.

   (iii) Accord of general sanction for the acquisition and allocation of budgetary resources to various activity units over the budgetary period.

   (iv) Devolution of necessary authority and fixing up of accountability for the planned performance standards and targets, among the various executive positions.

   (v) Establishment of appropriate system for monitoring, measuring and evaluating the pace and quality of operations on a continuous basis. This includes initiation of required measures to ensure that actual performance is in conformity with budgeted performance. Deviations and variances are analysed and remedial measures are taken to set them right.

2. **Financial Statements:** The annual financial statements of enterprises - Trading and Profit and Loss Account and Balance Sheet are powerful tools of control. They epitomize the financial dimension of enterprise operations at periodic intervals of time. The profit and Loss during a specified period while the Balance Sheet is a position statement of the financial status of the enterprise at the end of the specified period-Managers could analyse the financial statements of the previous period - historical statements to know the dynamics of revenue generation and incidence of expenditure as also the trends of changes in the liabilities, assets and net worth of the enterprise. Projected financial statements for the next year may also be prepared on the basis of forecasts and plans of the enterprise and these could also be used to monitor and regulate financial events and transactions which take place in the enterprise.

3. **Break-even analysis:** Also called Cost-Volume Profit analysis, break-even Analysis is a tool of control to size up the behaviour of costs, revenues and profit various levels of activity. It enables management to understand the amount of profit that can be expected at various volumes of operations, the appropriate volume of operations needed to obtain a target level of profit, and the impact of changes in product prices and costs on the volume of operations and profitability. Simple break-even graphs can be prepared on a rough basis by using the available or projected data of fixed and variable costs and sales volumes of the enterprise to arrive at the breakeven point - the point at which the total revenue is equal to total cost. It is a no profit no loss point. More complex break even analysis can be undertaken with the help of computers to project how small changes in unit prices, target profits and levels of activity influence one another. Break-even analysis is adopted as a tool of profit planning. It is thus a technique of both planning and control.

4. **Management information System (MIS):** MIS can be helpful to managers in carrying out the planning,

controlling and operational functions by gathering storing and converting data into useful information. MIS incorporates, historical, current and projected information—quantitative or non- quantitative. It provides information in summary or detailed form as needed by managers. It provides information for all types of decision issues-strategic, administrative and operational. It enables managers to improve the quality and timeliness of their decisions in particular and to systematize even their day-to- day functioning in general. It adds to the alertness, awareness and intelligence of managers by supplying information in the form of progress and review reports on on-going activity. Another role of MIS is to provide only that much information as called for by managers specifically for purposes of decision making. This means that the question of information overload does not arise and that only optimum information is provided. The information is also updated on a continuous basis so as to make it more relevant. MIS avoids furnishing of overlapping information as it will create confusion in the minds of managers. There is thus the desired degree of focus and selectivity in the information content.

5. **Management Audit:** The term 'Management Audit' is defined as a systematic evaluation of the functioning, performance and effectiveness of management of an organisation. It is thus an independent appraisal of an organization's management by an outside firm. Depending on the preferences and perspectives of top management audit may cover all or some major facts of functioning of the organisation and its management. A few major areas which could be exposed to the search lights of management audit are listed as follows:

   (1) Formulation of organisational objectives, strategies, policies and programmes of action and the manner in which they are pursued, as also the extent of success achieved.

   (2) Design and operation of organisational structures of roles, activities and relationships.

   (3) The manner and efficiency with which resources and assets are mobilised, developed, allocated, utilised and safeguarded, including the human resources.

   (4) Design and functioning of various systems and operations within the organisation.

   (5) The manner in which the management team anticipates and sizes up external environmental elements and designs appropriate adaptive strategies to cope with them.

   (6) The internal organisational climate - to what extent it is conducive for co-operation, harmony, creativity, productivity and satisfaction.

   (7) The quality of managerial decisions: their soundness, timeliness and effectiveness.

Organisation Structure, Responsibility, Accountability and Delegation of Authority

5.5

5.5.1 Organization Structure

An organisation structure shows the authority and responsibility relationships between the various positions in the organisation by showing who reports to whom. Organisation involves establishing an appropriate structure for the goal seeking activities. It is an established pattern of relationship among the components of the organisation. March and Simon have stated that- "Organisation structure consists simply of those aspects of pattern of behaviour in the organisation that are relatively stable and change only slowly." The structure of an organisation is generally shown on an organisation chart. It shows the authority and responsibility relationships between various positions in the organisation while designing the organisation structure, due attention should be given to the principles of sound organisation.

Significance of Organisation Structure

1. Properly designed organisation can help improve teamwork and productivity by providing a framework within which the people can work together most effectively.
2. Organisation structure determines the location of decision-making in the organisation.
3. Sound organisation structure stimulates creative thinking and initiative among organisational members by providing well defined patterns of authority.
4. A sound organisation structure facilitates growth of enterprise by increasing its capacity to handle increased level of authority.
5. Organisation structure provides the pattern of communication and coordination.
6. The organisation structure helps a member to know what his role is and how it relates to other roles.

Determining the Kind of Organisation Structure

According to Peter F Drucker-"Organisation is not an end in itself, but a means to the end of business performance and business results. Organisation structure is an indispensable means; and the wrong structure will seriously impair business performance and may even destroy it.

Organisation structure must be designed so as to make possible to attainment of the objectives of the business for five, ten, fifteen years hence". Peter Drucker has pointed out three specific ways to find out what kind or structure is needed to attain the objectives of a specific business:

1. **Activities Analysis:** The purpose of 'activities analysis' is to discover the primary activity of the proposed organisation, for it is around this that other activities will be built. It may be pointed out that in every organisation; one or two functional areas of business dominate.

   For example, designing is an important activity of the readymade garments manufacturer. After the activities have been identified and classified into functional areas, they should be listed in the order of importance.

2. **Decision Analysis:** At this stage, the manager finds out what kinds of decisions will need to be made to carry on the work of the organisation. What is even more important, he has to see where or at what level these decisions will have to be made and how each manager should be involved in them. This type of analysis is particularly important for deciding upon the number of levels or layers in the organisation structure.

3. **Relations Analysis:** Relations Analysis will include an examination of the various types of relationships that develop within the organisation. These relationships are vertical, lateral and diagonal. Where a superior-subordinate relationship is envisaged, it will be a vertical relationship. In case of an expert or specialist advising a manager at the same level, the relationship will be lateral. Where a specialist exercises authority over a person in subordinate position in another department in the same organisation it will be an instance of diagonal relationship.

Principles of Organisational Structure

The following are the main principles that a manager has to keep in mind while formulating an organisational structure.

1. **Consideration of unity of objectives:** The objective of the undertaking influences the organisation structure. There must be unity of objective so that all efforts can be concentrated on the set goals.

2. **Specialisation:** Effective organisation must include specialisation. Precise division of workfacilitates specialisation.

3. **Co-ordination:** Organisation involves division of work among people whose efforts must be co-ordinated to achieve common goals. Co-ordination is the orderly arrangement of group effort to provide unity of action in the pursuit of common purpose.

4. **Clear unbroken line of Authority:** It points out the scalar principle or the chain of command. The line of authority flows from the highest executive to the lowest managerial level and the chain of command should not be broken.

5. **Responsibility:** Authority should be equal to responsibility i.e., each manager should have enough authority to accomplish the task.

6. **Efficiency:** The organisation structure should enable the enterprise to attain objectives with the lowest possible cost.

7. **Delegation:** Decisions should be made at the lowest competent level. Authority and responsibility should be delegated as far down in the organisation as possible.

8. **Unity of Command:** Each person should be accountable to a single superior. If an individual has to report to only one supervisor there is a sense of personal responsibility to one person for results.

9. **Span of Management:** No superior at a higher level should have more than six immediate subordinates. The average human brain can effectively direct three to six brains (i.e., subordinates).

10. **Communication:** A good communication sub-system is essential for smooth flow of information and understanding and for effective business performance.

11. **Flexibility:** The organisation is expected to provide built in devices to facilitate growth and expansion without dislocation. It should not be rigid or inelastic.

Formal and Informal Organisation

The formal organisation refers to the structure of jobs and positions with clearly defined functions and relationships as prescribed by the top management. This type of organisation is built by the management to realise objectives of an enterprise and is bound by rules, systems and procedures. Everybody is assigned a certain responsibility for the performance of the given task and given the required amount of authority for carrying it out. Informal organisation, which does not appear on the organisation chart, supplements the formal organisation in achieving organisational goals effectively and efficiently. The working of informal groups and leaders is not as simple as it may appear to be. Therefore, it is obligatory for every manager to study thoroughly the working pattern of informal relationships in the organisation and to use them for achieving organisational objectives.

1. **Formal Organisation:** Chester I Bernard defines formal organisation as -"a system of consciously coordinated activities or forces of two or more persons. It refers to the structure of well-defined jobs, each bearing a definite measure of authority, responsibility and accountability." The essence of formal organisation is conscious common purpose and comes into being when persons:

   (a) Are able to communicate with each other

   (b) Are willing to act, and

   (c) Share a purpose.

   The formal organisation is built around four key pillars. They are:

   (a) Division of labour

   (b) Scalar and functional processes

   (c) Structure, and

   (d) Span of control

   Thus, a formal organisation is one resulting from planning where the pattern of structure has already been determined by the top management.

   Characteristic of Formal Organisation

   (a) Formal organisation structure is laid down by the top management to achieve organisational goals.

   (b) Formal organisation prescribes the relationships amongst the people working in the organisation.

   (c) The organisation structures is consciously designed to enable the people of the organisation to work together for accomplishing the common objectives of the enterprise.

   (d) Organisation structure concentrates on the jobs to be performed and not the individuals who are to perform jobs.

   (e) In a formal organisation, individuals are fitted into jobs and positions and work as per the managerial decisions. Thus, the formal relations in the organisation arise from the pattern of responsibilities that are created by the management.

   (f) A formal organisation is bound by rules, regulations and procedures.

   (g) In a formal organisation, the position, authority, responsibility and accountability of each level are clearly defined.

   (h) Organisation structure is based on division of labour and specialisation to achieve efficiency in operations.

   (i) A formal organisation is deliberately impersonal. The organisation does not take into consideration the sentiments of organisational members.

   (j) The authority and responsibility relationships created by the organisation structure are to be honoured by everyone.

(k) In a formal organisation, coordination proceeds according to the prescribed pattern.

Advantages of Formal Organisation

(a) The formal organisation structure concentrates on the jobs to be performed. It, therefore, makes everybody responsible for a given task.

(b) A formal organisation is bound by rules, regulations and procedures. It thus ensures law and order in the organisation.

(c) The organisation structure enables the people of the organisation to work together for accomplishing the common objectives of the enterprise.

Disadvantages or Criticisms of Formal Organisation

(a) The formal organisation does not take into consideration the sentiments of organisational members.

(b) The formal organisation does not consider the goals of the individuals. It is designed to achieve the goals of the organisation only.

(c) The formal organisation is bound by rigid rules, regulations and procedures. This makes the achievement of goals difficult.

2. **Informal Organisation:** Informal organisation refers to the relationship between people in the organisation based on personal attitudes, emotions, prejudices, likes, dislikes etc. an informal organisation is an organisation which is not established by any formal authority, but arises from the personal and social relations of the people.

   These relations are not developed according to procedures and regulations laid down in the formal organisation structure; generally large formal groups give rise to small informal or social groups. These groups may be based on same taste, language, culture or some other factor. These groups are not pre-planned, but they develop automatically within the organisation according to its environment.

Characteristics of Informal Organisation

(a) Informal organisation is not established by any formal authority. It is unplanned and arises spontaneously.

(b) Informal organisations reflect human relationships. It arises from the personal and social relations amongst the people working in the organisation.

(c) Formation of informal organisations is a natural process. It is not based on rules, regulations and procedures.

(d) The inter-relations amongst the people in an informal organisation cannot be shown in an organisation chart.

(e) In the case of informal organisation, the people cut across formal channels of communications and communicate amongst themselves.

(f) The membership of informal organisations is voluntary. It arises spontaneously and not by deliberate or conscious efforts.

(g) Membership of informal groups can be overlapping as a person may be member of a number of informal groups.

(h) Informal organisations are based on common taste, problem, language, religion, culture, etc. It is influenced by the personal attitudes, emotions, whims, likes and dislikes etc. of the people in the organisation.

Benefits of Informal Organisation

(a) It blends with the formal organisation to make it more effective.

(b) Many things which cannot be achieved through formal organisation can be achieved through informal organisation.

(c) The presence of informal organisation in an enterprise makes the managers planand act more carefully.

(d) Informal organisation acts as a means by which the workers achieve a sense of security and belonging. It provides social satisfaction to group members.

(e) An informal organisation has a powerful influence on productivity and job satisfaction.

(f) The informal leader lightens the burden of the formal manager and tries to fill in the gaps in the manager's ability.

(g) Informal organisation helps the group members to attain specific personal objectives.

(h) Informal organisation is the best means of employee communication. It is very fast.

(i) Informal organisation gives psychological satisfaction to the members. It acts as a safety valve for the emotional problems and frustrations of the workers of the organisation because they get a platform to express their feelings.

(j) It serves as an agency for social control of human behaviour.

Forms of Organisation

Organisation requires the creation of structural relationship among different departments and the individuals working there for the accomplishment of desired goals. Organisation structure is primarily concerned with the allocation of tasks and delegation of authority. The establishment of formal relationships among the individuals working in the organisation is very important to make clear the lines of authority in the organisation and to coordinate the efforts of different individuals in an efficient manner. According to the different practices of distributing authority and responsibility among the members of the enterprise, several types of organisation structure have been evolved. They are:

1. Line organisation
2. Line and staff organisation
3. Functional organisation
4. Committee organisation

Line Organisation

This is the simplest and the earliest form of organisation. It is also known as "Military", "traditional", "Scalar" or "Hierarchical" form of organisation. The line organisation represents the structure in a direct vertical relationship through which authority flows. Under this, the line of authority flows vertically downward from top to bottom throughout the organisation. The quantum of authority is highest at the top and reduces at each successive level down the hierarchy. All major decisions and orders are made by the executives at the top and are handed down to their immediate subordinates who in turn break up the orders into specific instructions for the purpose of their execution by another set of subordinates. A direct relationship of authority and responsibility is thus established between the superior and subordinate. The superior exercises a direct authority over his subordinates who become entirely responsible for their performance to their commanding superior. Thus, in the line organisation, the line of authority consists of an uninterrupted series of authority steps and forms a hierarchical arrangement. The line of authority not only becomes the avenue of command to operating personnel, but also provides the channel of communication, coordination and accountability in the organisation.

Prof. Florence enunciates three principles which are necessary to realise the advantages of this system and the nonobservance of which would involve inefficiency.

1. Commands should be given to subordinates through the immediate superior; there should be no skipping of links in the chain of command.
2. There should be only one chain. That is, command should be received from only one immediate superior.
3. The number of subordinates whose work is directly commanded by the superior should be limited.

Advantages or Merits of Line Organisation

1. It is the easiest to establish and simplest to explain to the employers.
2. It fixes responsibility for the performance of tasks in a definite manner upon certain individuals.
3. There is clear-cut identification of authority and responsibility relationship. Employees are fully aware of the boundaries of their job.
4. It is most economical and effective.
5. It makes for unity of control thus conforming to the scalar principle of organisation.
6. It ensures excellent discipline in the enterprise because every individual knows to whom he is responsible. The subordinates are also aware of the necessity of satisfying their superior in their own interests.
7. It facilitates prompt decision-making because there is definite authority at every level.
8. As all the activities relating to one department or division are managed by one executive, there can be effective coordination of activities.
9. This system is flexible or elastic, in the sense that, as each executive has sole responsibility in his own position and sphere of work, he can easily adjust the organisation to changing conditions.
10. Under this system, responsibility and authority are clearly defined. Every member of the organisation knows his exact position, to whom he is responsible and who are responsible to him. Because of the clear fixation of responsibility, no person can escape from his liability.

Disadvantages or Demerits of Line Organisation

1. With growth, the line organisation makes the superiors too overloaded with work. Since all work is done according to the wishes of one person alone, the efficiency of the whole department will come to depend upon the qualities of management displayed by the head of that department. If therefore, something happens to an efficient manager, the future of the department and of the concern as a whole would be in jeopardy.
2. Being an autocratic system, it may be operated on an arbitrary, opinionated and dictatorial basis. 3. Under this system, the subordinates should follow the orders of their superior without expression their opinion on the orders. That means there is limited communication.
4. There may be a good deal of nepotism and favouritism. This may result in efficient people being left behind and inefficient people getting the higher and better posts.
5. The line organisation suffers from lack of specialised skill of experts. Modern business is so complex that it is extremely difficult for one person to carry in his head all the necessary details about his work in this department.
6. Line organisation is not suitable to big organisations because it does not provide specialists in the structure. Many jobs require specialised knowledge to perform them.
7. If superiors take a wrong decision, it would be carried out without anybody having the courage to point out its

deficiencies.

8. The organisation is rigid and inflexible.

9. There is concentration of authority at the top. If the top executives are not capable, the enterprise will not be successful.

Prof. Florence, sums up the inefficiencies of the line organisation system under three heads:

(i) Failure to get correct information and to act upon it;

(ii) red-tape and bureaucracy;

(iii) Lack of specialised skill or experts.

In spite of these drawbacks, the line organisation structure is very popular particularly in small organisations where there are less number of levels of authority and a small number of people.

Line and Staff Organisation

In line and staff organisation, the line authority remains the same as it does in the line organisation. Authority flows from top to bottom. The main difference is that specialists are attached to line managers to advise them on important matters. These specialists stand ready with their speciality to serve line mangers as and when their services are called for, to collect information and to give help which will enable the line officials to carry out their activities better. The staff officers do not have any power of command in the organisation as they are employed to provide expert advice to the line officers. The combination of line organisation with this expert staff constitutes the type of organisation known as line and staff organisation. The 'line' maintains discipline and stability; the 'staff' provides expert information. The line gets out the production, the staffs carries on the research, planning, scheduling, establishing of standards and recording of performance. The authority by which the staff performs these functions is delegated by the line and the performance must be acceptable to the line before action is taken.

Types of Staff

The staff position established as a measure of support for the line managers may take the following forms:

1. **Personal Staff:** Here the staff official is attached as a personal assistant or adviser to the line manager. For example, Assistant to managing director.

2. **Specialised Staff:** Such staff acts as the fountainhead of expertise in specialised areas like R&D, personnel, accounting etc. For example, R&D Staff.

3. **General Staff:** This category of staff consists of a set of experts in different areas who are meant to advise and assist the top management on matters called for expertise. For example: Financial advisor, technical advisor etc.

Features of Line and Staff Organisation

1. Under this system, there are line officers who have authority and command over the subordinates and are accountable for the tasks entrusted to them. The staff officers are specialists who offer expert advice to the line officers to perform their tasks efficiently.

2. Under this system, the staff officers prepare the plans and give advise to the line officers and the line officers execute the plan with the help of workers.

3. The line and staff organisation is based on the principle of specialisation.

Advantages of Line and Staff Organisation

1. It brings expert knowledge to bear upon management and operating problems. Thus, the line managers get the benefit of specialised knowledge of staff specialists at various levels.
2. The expert advice and guidance given by the staff officers to the line officers benefit the entire organisation.
3. As the staff officers look after the detailed analysis of each important managerial activity, it relieves the line managers of the botheration of concentrating on specialised functions.
4. Staff specialists help the line managers in taking better decisions by providing expert advice. Therefore, there will be sound managerial decisions under this system.
5. It makes possible the principle of undivided responsibility and authority, and at the same time permits staff specialisation. Thus, the organisation takes advantage of functional organisation while maintaining the unity of command.
6. It is based upon planned specialisation.
7. Line and staff organisation has greater flexibility, in the sense that new specialised activities can be added to the line activities without disturbing the line procedure.

Disadvantages of Line and Staff Organisation

1. Unless the duties and responsibilities of the staff members are clearly indicated by charts and manuals, there may be considerable confusion throughout the organisation as to the functions and positions of staff members with relation to the line supervisors.
2. There is generally a conflict between the line and staff executives. The line managers feel that staff specialists do not always give right type of advice, and staff officials generally complain that their advice is not properly attended to.
3. Line managers sometimes may resent the activities of staff members, feeling that prestige and influence of line managers suffer from the presence of the specialists.
4. The staff experts may be ineffective because they do not get the authority to implement their recommendations.
5. This type of organisation requires the appointment of large number of staff officers or experts in addition to the line officers. As a result, this system becomes quite expensive.
6. Although expert information and advice are available, they reach the workers through the officers and thus run the risk of misunderstanding and misinterpretation.
7. Since staff managers are not accountable for the results, they may not be performing their duties well.
8. Line mangers deal with problems in a more practical manner. But staff officials who are specialists in their fields tend to be more theoretical. This may hamper coordination in the organisation.

Functional Organisation

The difficulty of the line organisation in securing suitable chief executive was overcome by F.W. Taylor who formulated the Functional type of organisation. As the name implies, the whole task of management and direction of subordinates should be divided according to the type of work involved. As far as the workman was concerned, instead of coming in contact with the management at one point only, he was to receive his daily orders and help directly from eight different bosses; four of these were located in the planning room and four in the shop. The four specialists or bosses in the planning room are:

1. Route Clerk: To lay down the sequence of operations and instruct the workers concerned about it.

2. **Instruction Card Clerk:** To prepare detailed instructions regarding different aspects of work.
3. **Time and Cost Clerk:** To send all information relating to their pay to the workers and to secure proper returns of work from them.
4. **Shop Disciplinarian:** To deal with cases of breach of discipline and absenteeism.

The four specialists or bosses at the shop level are:

1. **Gang Boss:** To assemble and set up tools and machines and to teach the workers to make all their personal motions in the quickest and best way.
2. **Speed Boss:** To ensure that machines are run at their best speeds and proper tools are used by the workers.
3. **Repair Boss:** To ensure that each worker keeps his machine in good order and maintains cleanliness around him and his machines.
4. **Inspector:** To show to the worker how to do the work.

It was F.W. Taylor who evolved functional organisation for planning and controlling manufacturing operations on the basis of specialisation. But in practice, functionalisation is restricted to the top of the organisation as recommended by Taylor.

Features of Functional Organisation

The features of functional organisation are as follows:

1. The work of the enterprise is divided into different functional departments and the different functional departments are placed under different specialists.
2. The functional specialist has the authority or right to give orders regarding his function whosesoever that function is performed in the enterprise.
3. Under this system, the workers have to receive instructions from different specialists.
4. If anybody in the enterprise has to take any decision relating to a particular function, it has to be in consultation with the functional specialist.
5. Under this system, the workers have to perform a limited number of functions.

Advantages of Functional Organisation

1. Functional organisation is based on expert knowledge. Every functionary in charge is an expert in his area and can help the subordinates in better performance in his area.
2. Division of labour is planned not incidental.
3. As there is not scope for one-man control in this form of organisation, this system ensure co-operation and teamwork among the workers.
4. This system ensures the separation of mental functions from manual functions.
5. It helps mass production by standardization and specialization.
6. This system ensures maximum use of the principle of specialisation at every work point.
7. As there is joint supervision in the organisation, functional organisation reduces the burden on the top executives.
8. Functional organisation offers a greater scope for expansion as compared to line organisation. It does not face

the problem of limited capabilities of a few line managers.

9. The expert knowledge of the functional mangers facilitates better control and supervision in the organisation.

Disadvantages of Functional Organisation

1. It is unstable because it weakens the disciplinary controls, by making the workers work under several different bosses. Thus, functional organisation violates the principle of unity of command.
2. Under this type of organisation, there are many foremen of equal rank. This may lead to conflicts among them.
3. The co-ordinating influence needed to ensure a smoothly functioning organisation may involve heavy overhead expenses.
4. The inability to locate and fix responsibility may seriously affect the discipline and morale of the workers through apparent or actual contradiction of the orders.
5. This system is very costly as a large number of specialists are required to be appointed.
6. A functional manager tends to create boundaries around himself and think only in term of his own department rather than of the whole enterprise. This results in loss of overall perspective in dealing with business problems.
7. It is difficult for the management to fix responsibility for unsatisfactory results.

Committee Organisation

Committee organisation as a method of managerial control has very little practical importance, because it is managed by a senior member of the committee only. But the committee organisations are widely used for the purpose of discharging advisory functions of the management.

Committees are usually relatively formal bodies with a definite structure. They have their own organisation. To them are entrusted definite responsibility and authority.

According to Hicks, "A committee is a group of people who meet by plan to discuss or make a decision for a particular subject."

According to Louis A Allen, "A committee is a body of persons appointed or elected to meet on an organised basis for the consideration of matters brought before it."

A committee may formulate plans, make policy decisions or review the performance of certain units. In some cases, it may only have the power to make recommendations to a designated official. Whatever may be the scope of their activities, committees have come to be recognised as an important instrument in the modern business as well as non-business organisations.

Objectives of Committees

Committees are constituted to achieve one or more of the following objectives:

1. To have consultations with various persons to secure their view-points
2. To give participation to various groups of people
3. To secure cooperation of different departments
4. To coordinate the functioning of different departments and individuals by bringing about unity of directions.

Types of Committees

1. **Line committee:** If a committee is vested with the authority and responsibility to decide and whose decisions are implemented, it is known as line committee.

2. **Staff committee:** If a committee is appointed merely to counsel and advise, it is known as a staff committee.
3. **Formal committee:** When a committee is constituted as a part of the organisation structure and has clear-cut jurisdiction, it is a formal committee.
4. **Informal committee:** An informal committee is formed to advice on certain complicated matters. It does not form part of the organisation structure.
5. **Coordinating committee:** It is constituted to coordinate the functioning of different departments.
6. **Executive committee:** It is a committee which has power to administer the affairs of the business.
7. **Standing committee:** are formal committees that are of permanent character.
8. **Ad hoc committee:** They are temporary bodies. It is appointed to deal with some special problem and stops functioning after its job are over.

Advantages of Committee

1. A committee is an effective method of bringing the collective knowledge and experience of a number of persons. Therefore, many multi-dimensional and complex problems of modern enterprises, which cannot be solved satisfactorily by individual managers, can be solved by committees.
2. Committees offer scope for group deliberations and group judgment. Results obtained by group deliberation and group judgment are likely to be better than those obtained by individual judgment.
3. When it is necessary to integrate varying points of view, which cannot conveniently be coordinated by individuals, the committee may be used to bring about coordination.
4. The management can give representation to the employees in various committees. This will motivate the employees for better performance as they feel that they have a say in the affairs of the organisation.
5. A committee form of organisation facilitates pooling of authority of individual managers for making some type of decisions of an inter-departmental nature.
6. A committee form of organisation tends to promote organisational cohesiveness. Group endeavour, team spirit and collective responsibility are control to the philosophy of committees.

Disadvantages of Committee

1. If a manager has an opportunity to carry a problem to a committee, he may take it as a means of avoiding decision-making or to escape the consequences of an unpopular decision.
2. Sometimes, a committee may not be able to take the needed decision because of the conflicting views of the members.
3. Committees take more time in procedural matters before any decision is taken. In some cases, slowness seriously handicaps the administration of the organisation.
4. Committees are an expensive device both in terms of cost and time.
5. When the committee findings represent a compromise of different viewpoints, they may be found to be weak and indecisive.
6. No member of a committee can be individually held responsible for the wrong decision taken by the committee.
7. It is very difficult to maintain secrecy regarding the deliberations and the decisions taken by a committee, especially when there are many members in the committee.

5.5.2 Concept of Responsibility

The term responsibility is used in management literature in two different senses. Some writers have defined it as duty or task assigned to a subordinate by virtue of his position in the organization. According to M.E. Hurley, "Responsibility is the duty to which a person is bound by reason of his status or task. Such responsibility implies compliance with directives of the person making the initial delegation."

In a more comprehensive sense responsibility may be defined as the obligation of an individual to perform the duty assigned to him. According to Koontz and O'Donnell, "Responsibility may be defined as the obligation of a subordinate, to whom duty has been assigned to perform the duty." Responsibility is an obligation to perform certain functions and to achieve certain results. According to R. C. Davis, "Responsibility is the obligation of an individual to perform assigned duties to the best of his ability under the direction of his executive leader."

Characteristics of Responsibility

The main characteristics of responsibility are as follows:

1. Responsibility can be assigned to human beings only. Non-living objects such as a machine cannot be assigned responsibility.
2. Responsibility arises from a superior-subordinate relationship. By virtue of his superior position, a manager has the authority to get the required work done from his subordinates. Therefore, he assigns duties to subordinates who are bound by the service contract to perform the assigned duties.
3. Responsibility may be a continuing obligation or confined to the performance of a single function. For example, a sales person has continuing obligation to the sales manager. on the other hand, the responsibility of a management consultant to a company comes to an end as soon as the consultancy assignment is completed.
4. Responsibility may be defined in terms of functions or targets or goals. For example, the responsibility of labour officer is in the terms of a function. On the contrary, the responsibility of a worker who is assigned the job of producing 50 units daily is in terms of targets as far as possible responsibility should be expressed in terms of targets. This will enable the subordinates to know by what standards their performance will be evaluated.
5. The essence of responsibility is obligation of a subordinate to perform the duty assigned to him.
6. Responsibility is a derivative of authority. When a subordinate is delegated authority he becomes responsible to his superior for the performance of assigned task and for proper use of delegated authority. Therefore, responsibility should be commensurate with authority.
7. Responsibility is absolute and cannot be delegated. A subordinate may himself perform the duty assigned to him or he may get it done from his own subordinate. But he remains responsible to his own superior in both the cases. According to R.C. Davis, "Responsibility operates somewhat like the table of the magic pitcher in which the water level always remains the same, no matter how much water is poured out."
8. Responsibility flows upward. A subordinate is always responsible to his superior.
9. The person who accepts responsibility is accountable for his performance. Accountability arises out of responsibility and the two go together.

Techniques of Responsibility

Management can use various techniques to define responsibilities so as to actively involve members of an organization in its coordination effort. Two such techniques are:

(1) responsibility charting, and

(2) role negotiation.

Moreover, new organizational positions may be created and line and staff conflict resolved by enhancing the degree of coordination.

1. **Responsibility Charting –** a responsibility chart is a nice way of summarizing the relationship between tasks and actors (performers). The chart lists activities that are complicated or the decisions that must be made and the individuals who are responsible for each of them. On the vertical axis we show the tasks and on the horizontal axis we show the actors.

   The following four roles are important:

   1. The individual is responsible for the activity or decision.
   2. The individual must approve the activity or decision.
   3. The individual must be consulted before completing the activity or making the decision.
   4. The individual has to be informed about the activity or the decision.

2. **Role Negotiation –** Role negotiation is an important technique that can supplement the use of responsibility charting. If used properly, it can lead to clear definitions of tasks and the responsibilities associated with them.

The basic promise of the technique is that nobody gets anything without promising something in exchange. Organizational members meet at periodic intervals to list rededication of tasks so that coordination can be maximized.

The primary objective of this approach is to identify the independent clusters of tasks completed by the organization.

The second objective is to match the personal needs and work preference of individuals with the tasks that must be completed.

5.5.3. Accountability

It is the liability created for the use of authority. it is the answerability for performance of the assigned duties. Accountability is concerned with the fact that each person who is given authority and responsibility must recognize that the executive above him or her will judge the quality of his/her performance.

By accepting authority, a person denotes the acceptance of responsibility and accountability. The person who is delegating authority requires subordinates to allow their performance to be reviewed and evaluated and holds them accountable for result.

Here are six core behaviors that mark strong accountability in managers-

1. **Setting clear expectations**

   Managers should clearly articulate each team member's roles and responsibilities—this helps people to understand the expectations their supervisors have of them. Having a defined set of expectations provides team members with purpose and an achievable path to meet their goals. With goals in place that are easy to identify, your team is more likely to meet the objectives you set for them, and you can track accountability with ease.

2. **Providing meaningful feedback**

   An accountable manager has an obligation to provide consistent and timely feedback regarding employee performance. This feedback is crucial to improving each person's performance over time, which directly impacts individual success and collective team goals. Consider having a formal employee review process to fulfill this obligation. This also allows employees to plan for their regular review sessions and bring any ideas or concerns to your attention in an organized way.

3. **Establishing the workplace hierarchy**

   It's important that managers outline, and adhere to, a clearly defined workplace hierarchy. It's helpful to ensure employees have an accurate understanding of how the hierarchy works and how it supports the overall mission of the company. When each member of a company possesses easy access to their organization chart, you provide a culture in which employees see how their individual actions impact their team, department and related entities.

4. **Focusing on team cohesion**

   Accountable managers focus on the cohesion of their team, as employee who work well together often feel naturally motivated to be accountable to one another. Additionally, a focus on team cohesion reminds each member that they have a role to play in achieving the group goals. Strong communication between team members, a feeling of responsibility to each other and an eagerness to help each other out are all examples of team cohesion.

5. **Leading by example**

   Leading by example simply means that you should follow the same expectations you hold of your team. This includes requirements regarding the day-to-day execution of job functions and interpersonal requirements like maintaining a positive attitude, a willingness to assist others and an open and honest communication policy.

6. **Identifying and fostering growth**

   Accountability as a manager also means identifying the strengths and skills of your team. To do this well, you might foster each person's skills so that they can grow in their career. To do this, you might speak with your employees one-on-one to gain an understanding of their career goals, then work to identify projects and resources that can help them achieve those goals.

Accountability versus responsibility

Accountability is not the easiest term to grasp, and there's often a tendency to confuse it with responsibility. Here's how the two are different. With accountability, someone is held to account and the action must result. By contrast, responsibility is more values driven, coming from within. In other words, one who is accountable must complete something. But one who feels responsible truly believes that what they need to do is important. To be clear, responsibility is essential in organizations. Workers should feel responsible for doing good work and completing tasks. Nevertheless, there is a clear difference between responsibility and accountability.

In addition to confusing accountability with responsibility, through our research we discovered that there are two dimensions of accountability. Felt accountability is how strongly you feel accountable for doing good work. Clarity of accountability is how clear you are about those things for which you are accountable.

In many organizations, strategic direction is articulated by the Chief Executive Officer (CEO). But, if he or she isn't clear with subordinate Vice Presidents in terms of what they are accountable for doing, then organizational drift occurs. From the Chief Financial Officer (CFO) to the Chief Operations Officer (CFO) through all the VP-level roles, each VP looks at work through her or his own unique filter, impacting how they execute and set priorities.

Clarity of accountability, starting at the very top and throughout the entire organization ensures everyone is pulling the company in the same direction, reinforcing each other's work with complete transparency about what they are accountable for. When this happens, smart decision-making occurs and employees take initiatives with certainty that they are helping the organization do the work that is most important.

5.5.4 Delegation of Authority

Delegation is the act of assigning formal authority and responsibility for completion of specific activities to a subordinate. Delegation has three elements authority, responsibility and accountability. Delegation of authority is "the process a manager follows in dividing the work assigned to him so that he performs that part which only he, because of his unique organisational placement, can perform effectively and so that he can get others to help with what remains." The delegation of authority by superiors to subordinates is obviously necessary for the efficient functioning of any organisation, since no superior can personally accomplish or completely supervise all organisations. Now the questions are how can authority be delegated and responsibility be delegated? A clear line of authority is the basis for all delegation.

Concept of Authority in Management

In management, authority may be defined, as the right to guide and direct the actions of others and to secure from them responses which are appropriate to the attainment of the goals of the organization. it is the right to utilize organizational resources and to make decisions. Authority is the right to decide and to direct others to perform certain duties in achieving organizational goals. It refers to the right to make decisions and to get the decisions carried out. It is the right to act.

According to Barnard, "Authority is the character of communication (order) in a formal organization by virtue of which it is accepted by a contributor to, or member of the organization as generating the action he contributes, that is, as governing or determining what he does or is not to do so far as the organization is concerned."

In the words of Simon, "Authority may be defined as the power to take decisions which guide the actions of others."

In classical view, authority originates at some very high level of society and then is lawfully passed down from level to level. Usually, management has a right to give lawful orders and subordinates have an obligation to obey. This obligation is in effect, self-imposed. According to the acceptance viewpoint, whether or not author authority is present in any particular law or order is determined by the receiver not the issuer of the order.

Characteristics of Authority

The main characteristics of authority are as follows:

1. The authority given to a position is legal and legitimate. It is supported by tradition, law or standards of authenticity. Authority is formal.
2. The authority (right) enjoyed by a position is not unlimited. The extent and limits of authority of a position are defined in advance. The position holder is expected to use his authority as per rules, regulations, policies and norms of the organization.
3. Authority is a relationship between two individuals – one superior and the other subordinate. The superior frames and transmits decisions with the expectation that the subordinates will accept them. The subordinate executes such decisions and his conduct is determined by them.
4. Authority is used to achieve organizational goals. The basic purpose behind the use of authority is to influence the behavior of the subordinates in terms of doing right things at right time so that organizational objectives are achieved. A person with authority influences the behavior of others that might otherwise not take place.
5. Actions and behaviours of his subordinates. It provides the basis for getting things done. Authority is also the means of coordination is an organization. Lines of authority serve to link and integrate the various parts of the organization to achieve common goals.
6. Authority gives right of decision-making because a manager can give orders only when he decides what his subordinates should or should not do. in the words of terry, "authority is exercised by making decisions and seeing that they are carried out."
7. Authority in itself is an objective thing but its existence is always subjective. Its exercise depends upon the

personality factors of the manager who can use it and on the subordinates with whom it is to be exercised.

Line and Staff Authority

Every organisation exists to achieve specific goals. Line managers are directly responsible for achieving these goals. Line authority is represented by the standard chain of command, starting with the board of directors and extending down through the various levels in the hierarchy to the point where the basic activities of the organisation are carried out.

Staff authority belongs to those individuals or groups are organisations who provide services and advice to line managers. Staff can offer line mangers planning advice through research, analysis and options development. Staff can also assist in policy implementation, monitoring and control, in legal and financial matters.

Characteristics of Delegation of Authority

Delegation has the following characteristics:

1. Delegation takes place when a superior grants some discretion to a subordinate. the subordinate must act within the limits prescribed by the superior. He is not free to use authority arbitrarily but has to use it subject to the policies and rules of the organisation.

2. A manager cannot delegate the entire authority to his subordinates because if he delegates all his authority he passes his position to the subordinates.

3. Generally authority regarding routine decisions and for execution of policies is delegated to subordinates. A manager retains the authority to take policy decisions and to exercise control over the activities of subordinates.

4. The extent of authority which is delegated depends upon several factors, e.g., the ability philosophy of management, the confidence of the superior in his subordinates, etc.

5. Delegation does not imply reduction in the authority of a manager. a superior retains authority even after delegation. Delegation does not mean a manager loses control and power. He can reduce, enhance or take back the delegated authority.

6. Delegation may be specific or general, written or implied, formal or informal. Delegation does not mean avoiding decisions or abandonment of work.

7. Delegation does not mean abdication of responsibility. No manager can escape from his obligation by delegating authority to subordinates. Therefore, he must provide a means of checking upon the work that is done for him to ensure that it is done as he desires.

Importance of Delegation

Delegation is the dynamics of management and the essence of sound organisation. The importance of delegation is due the following advantages that it provides:

1. It enables the managers to distribute their workload to others. By reducing the workload for routine matters, they can concentrate on more important policy matters.

2. Delegation facilitates quick decisions because the authority to make decisions lies near the point of action. Subordinates need not approach the boss every time need for a decision arises.

3. Delegation helps to improve the job satisfaction, motivation and morale of subordinates. It helps to satisfy their needs for recognition, responsibility and freedom.

4. By clearly defining the authority and responsibility of subordinates, a manager can maintain healthy relationships with them. Delegation increases interaction and understanding among managers and subordinates.

5. Delegation binds the formal organisation together. It establishes superior-subordinate relationships and provides a basis for efficient functioning of the organisation.

6. Delegation enables a manager to obtain the specialized knowledge and expertise of subordinates.

7. Delegation helps to ensure continuity in business because managers at lower levels are enabled to acquire valuable experience in decision making. They get an opportunity to develop their abilities and can fill higher positions in case of need. Thus, delegation is an aid to executive development.4It also facilitates the expansion and diversification of business through a team of competent and contented workers. But for delegation firms would remain small.

Steps in the Process of Delegation

The process of delegation involves the following steps:

1. **Determination of results expected–** First of all, a manager has to define the results he wants to obtain from his subordinates for achievement of organisational objectives.

2. **Assignment of duties–** The manager then assigns specific duties or tasks to each subordinate. He must clearly define the function of each subordinate. While assigning duties and responsibilities, he must ensure that the subordinates understand and accept their duties. duties should be assigned according to the qualifications, experience and aptitude of the subordinates.

3. **Granting of authority–** Assignment of duties is meaningless unless adequate authority is given to subordinates. They cannot discharge their responsibilities without adequate authority. Enough authority must be granted so that subordinates can perform their duties. By granting authority, subordinates are permitted to use resources, to take decisions and to exercise discretion.

4. **Creating accountability for performance–** the subordinates to whom authority is delegated must be made answerable for the proper performance of assigned duties and for the exercise of the delegated authority. the extent of accountability depends upon the extent of delegation of authority and responsibility. a person cannot be held answerable for the acts not assigned to him by his superior. An information and control system is established to check and evaluate performance of the subordinates to whom authority is delegated.

Thus, duty, authority and accountability are three fundamental components of delegation. all the three phases of delegation are interdependent. ‘These three inevitable attributes of delegation are like a three-legged stool each depends on the others to support the whole and no two can standalone.”

Difficulties in Delegation

On the part of Delegator (Non-delegation) – managers are often reluctant to delegate adequate authority due to the following reasons:

1. Some managers may not delegate authority because of their lure for authority. They are autocrats and think that delegation will lead to reduction of their influence in the organisation. They want to make their presence felt and desire that subordinates should come frequently for approval. They like to dominate the whole show.

2. Some managers feel that none can do the job as well as they can do. They think that if they delegate, work will not be done as it ought to be done. They consider themselves indispensable and do not want to give other people’s ideas, a chance.

3. When a manager is incompetent his work methods and procedures are likely to be faulty. He keeps all the authority to himself for fear of being exposed. He is afraid that if he lets the subordinates make decisions they may outshine him. He is afraid of losing his importance.

4. Few managers are inclined to accept the risk of wrong decisions which the subordinates might take. Therefore,

they do not delegate authority and take all the decisions themselves. They are unwilling to take calculated risk.

5. A manager may not delegate authority because his feels that his subordinates are not capable and reliable. He lacks confidence in his subordinates.

6. A manager is not likely to delegate authority when he cannot issue suitable directions to guide the activities of subordinates. Such lack of ability to direct indicates that he is unfamiliar with the art of delegation.

7. Effective delegation requires adequate controls and a means of knowing the proper use of authority. a manager will hesitate to delegate authority if he has no means to ensure that the authority is being properly used by the subordinates.

On the part of Subordinates (Non-acceptance of Delegation) – subordinates may not like to accept delegation and shoulder responsibility due to the following reasons:

1. Subordinates may be reluctant to accept delegation when they lack self-confidence.

2. Some subordinates are unwilling to accept authority due to the desire to play safe by depending on the boss for all decisions. They have a love for spoon-feeding.

3. A subordinate who is afraid of committing mistakes and does not like to be criticised by the boss is likely to avoid delegation of authority.

4. When the subordinates are already overburdened with duties, they do not like additional responsibility through delegation.

5. Subordinates are likely to avoid delegation when adequate information, working facilities and resources are not available for proper discharge of duties.

6. Subordinates may not come forward to accept delegation of authority when no incentives are available to them.

Effective Delegation

Delegation of authority cannot be effective unless certain principles are followed in practice. While delegating authority, a manager should observe the following principles:

1. **Functional definition–** Before delegating authority a manager should define clearly the functions to be performed by subordinates. The objectives of each job, the activities involved in it and its relationship with other jobs should be defined.

2. **Delegation by results expected–** Authority should be delegated only after the results to be achieved by the subordinates are decided. This will enable them to know by what standards their performance will be judged.

3. **Parity of authority and responsibility–** There must be a proper balance between authority and responsibility of a subordinate. Responsibility without authority will make a subordinate ineffective as he cannot discharge his duties. Similarly, authority without responsibility will make the subordinate irresponsible. Therefore, authority and responsibility should be co-extensive.

4. **Absoluteness of responsibility–** Responsibility cannot be delegated. No manager can avoid his responsibility by delegating his authority to subordinates. after delegating authority he remains accountable for the activities of his subordinates. Similarly, the subordinates remain accountable to their superior for the performance of assigned duties.

5. **Unity of command–** At one time a subordinate should receive command and be accountable to only one superior. If a person reports to two superiors for the same job, confusion and conflict will arise. He may receive conflicting orders and his loyally will be divided. Therefore, dual subordination should be avoided.

6. **Well-defined limits of authority–** The limits of authority of each subordinate should be clearly defined. This will avoid overlapping of authority and will allow the subordinate to exercise initiative. He should refer those matters to the superior which are outside the limits of his authority.

7. **Authority level principle–** Managers at each level should make all decisions within their jurisdiction. They should avoid the temptation to refer to their superiors' decisions which they are authorized to take themselves. Only matters outside the scope of authority should be referred to superiors.

Centralization and Decentralization of Authority

Centralisation and decentralisation are opposite terms. They refer to the location of decision- making authority in an organisation. Centralisation implies the concentration of authority at the top level of the organisation while decentralisation means dispersal of authority throughout the organisation.

According to Allen, "Centralisation is systematic and consistent reservation of authority at central points within an organisation. Decentralisation applies to the systematic delegation of authority in an organisation wide context."

Decentralisation refers to the systematic effort to delegate to the lowest levels all authority except that which can only be exercised at central points. It is the distribution of authority throughout organisation.

Centralisation and decentralisation are relative terms because every organisation structure contains both the features. There cannot be complete centralisation or decentralisation in practice. Absolute centralisation means each and every decision is to be taken by top management which is not practicable. Similarly, absolute decentralisation implies no control over the activities of subordinates which cannot be possible. Therefore, effective decentralisation requires a proper balance between dispersal of authority among lower levels and adequate control over them. Decentralisation should not be confused with dispersion of physical facilities and operations.

Distinction between Delegation and Decentralisation

Decentralisation is much more than delegation. Delegation means transfer of authority from one individual to another. But decentralisation implies diffusion of authority throughout the organisation. The main points of distinction between delegation and decentralisation are presented as follows:

1. Delegation is the process of devolution of authority whereas decentralisation is the end result which is achieved when delegation is systematically repeated up to the lowest level.

2. Delegation can take place from one individual (superior) to another (subordinate) and -be a complete process. But decentralisation is completed only when the fullest possible delegation is made at all levels of organisation.

3. In delegation control rests entirely with the superior. But in decentralisation the top management exercises only overall control and delegates the authority for day today control to the departmental managers.

4. Delegation is a must for management as subordinates must be given sufficient authority to perform their duties. But decentralisation is optional in the sense that top management may or may not disperse authority.

5. Delegation is a technique of management used to get things done through others. However, decentralisation is both a philosophy of management and a technique.

Advantages of Decentralisation

The main benefits of decentralisation are as follows:

1. **Relief to top executives–** Decentralisation helps in reduction of the workload of top executives. They can devote greater time and attention to important policy matters by decentralising authority for routine operational decisions.

2. **Motivation of subordinates–** Decentralisation helps to improve the job satisfaction and morale of lower level

managers by satisfying their needs for independence, participation and status. It also fosters team—spirit and group cohesiveness among the subordinates.

3. **Quick decisions–** Under decentralisation authority to make decisions are placed in the hands of those who are responsible for executing the decisions. as a result, more accurate and faster decisions can be taken as the subordinates are well aware of the realities of the situation. This avoids red tapism and delays.

4. **Growth and diversification–** Decentralisation facilitates the growth and diversification of the enterprise. Each product division is given sufficient autonomy for innovations and creativity. The top management can extend leadership over a giant enterprise. A sense of competition can be created among different divisions or departments.

5. **Executive development–** When authority is decentralised, subordinates get the opportunity of exercising their own judgment. They learn how to decide and develop managerial skills. As a result, the problem of succession is overcome and the continuity and growth of the organisation are ensured. There is better utilisation of lower-level executives.

6. **Effective communication–** Under decentralisation, the span of management is wider and there are fewer hierarchical levels of organisation. Therefore, communication system becomes more effective. Intimate relationships between superiors and subordinates can be developed.

7. **Efficient supervision and control–** Managers at lower levels have adequate authority to make changes in work assignments, to change production schedules, to recommend promotions and to take disciplinary actions. Therefore, more effective supervision can be exercised. Control can be made effective by evaluating the performance of each decentralised unit in the light of clear and predetermined standards. Decentralisation facilitates management by objectives and self-control.

Disadvantages of Decentralisation

Decentralisation suffers from the following limitations:

1. **Expensive–** Decentralisation increases the administrative expenses. Each division or department has to be self-sufficient in terms of physical facilities and trained personnel. There may be duplication of functions and underutilization of facilities. Therefore, a decentralised set-up is better suited to large enterprises.

2. **Difficulty in co-ordination–** Under decentralisation, each department or division enjoys substantial autonomy. Therefore, coordination among the departments becomes more difficult.

3. **Lack of uniformity–** decentralisation may lead to inconsistencies when uniform procedures are not followed by various departments. Each department may formulate its own policies and procedures.

4. **Narrow product lines–** decentralisation requires that product lines should be broad enough to permit creation of autonomous units. Therefore, it is not suitable for small firms having narrow product lines. Similarly, decentralisation may not be possible when there is lack of competent managers at lower levels in the organisation.

5. **External constraints–** decentralisation may not be possible due to external factors like market uncertainties, trade union movement, government intervention, etc.

Factors Determining Decentralisation

While deciding the degree of decentralisation in a particular organisation, the following factors should be taken into consideration:

1. **Size and complexity of the organisation–** in a large and complex organisation there is greater need for decentralisation. But in a relatively small and simple organisation, top management can make most of the

decisions and creation of autonomous units may be a very costly scheme.

2. **Dispersal of operations–** When the production and sales of an enterprise are geographically scattered, centralised control becomes very difficult and there is greater pressure for decentralisation of authority. But if all the activities are located in one building centralised control is much easier.

3. **Degree of diversification–** In a company having several diverse product lines, decentralisation is not only necessary but beneficial. High degree of standardisation, on the other hand, results in centralisation.

4. **Availability of competent personnel–** It is advisable to decentralize authority only when managers at lower levels are able and experienced. Lack of trained executives will restrict decentralisation.

5. **Outlook of top management–** When the top executives believe in individual freedom, there will be a high degree of decentralisation. But if top management is conservative and prefers centralized control it is likely to centralize authority.

6. **Nature of functions–** generally, basic functions like production and sales are more decentralized than staff functions such as personnel, finance, research and development.

7. **Communication system–** An effective communication system is required to co-ordinate and controls the activities of operational units. In case communication system is ineffective, centralization should be advocated. However, computerised management information system has enabled centralised decision-making.

9. **Planning and control procedures–** If the organisation has clear objectives and policies, superiors are more willing to allow subordinates to make decisions independently. Decentralisation can be successful when there is a sound system of control. Such a system would enable the top management to determine the effectiveness of decisions made by subordinates.

10. **Complexities of the situation–** Environmental factors exercise significant influence on the degree of decentralisation. For example, where business conditions are highly uncertain, high degree of freedom to operating units may endanger the very existence of the enterprise.

Purposes of Centralisation

1. To facilitate personal leadership. In the early stages of an enterprise and in small firms, the success depends largely on the personal leadership of a dynamic and talented leader. Authority may be centralised to give full scope to facilitate personal leadership which may result in quick decisions and imaginative action.

2. To provide integration. Co-ordination of individual efforts is essential to the success of every organisation. Centralised direction is an effective means of unification and integration of individual efforts. It acts as a binding force on the various units of the organisation.

3. To achieve uniformity of action. Where uniformity of policy and action is required, authority may be centralised at the top. Such uniformity is often desirable in personnel, purchasing and advertising. Therefore, authority in these tends to be centralised.

4. To improve efficiency. Centralisation helps to avoid overlapping efforts and duplication of work. It enables the management to exercise effective control in order to minimize waste and to achieve economy in operations.

Effective Decentralisation

Effective decentralisation requires fulfilment of the following conditions:

1. Appropriate centralisation– Decentralisation can be effective when there is a centralised authority for overall planning and control. The central authority ensures close coordination between various operating units. Without such a cementing force, the decentralised organisation may fall apart into pieces.

2. Development of managers– Effective decentralisation requires a large number of highly competent managers who are capable of working independently. In order to develop such executives, top management must delegate authority and allow the subordinates to learn through experience in making decisions.

3. Open communication– a sound communication system should be established to ensure continuous interaction between superiors and subordinates. Necessary feedback on operating results should be made available to superiors. Open communication system will enable managers to provide advice and guidance to subordinates.

4. Coordination–Decentralisation tends to create rivalry and cooperating divisions. Departmental managers compete for scarce resources. Effective coordination is essential to prevent such disintegrating tendencies. Interdepartmental coordination helps to prevent the danger of fragmentation. Committees, liaison officers and other mechanisms of coordination may be used to ensure coordination.

5. Adequate controls– Effective decentralisation needs an appropriate control system that will distribute the resources, lay down standards of performance and exercise control to ensure that the various operating units are working in the desired direction.

Span of Management

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.

Example of Graicunas formula-

Consider if a superior has 5 subordinates then number of relationships aas per Graicunas formula will be as follows-

No. of direct relationships = n=5

No. of cross relationships = n (n-1)= 5(5-1)=20

No. of group relationships = n [2^{n-1} -1]= 5 (24-1)=75

Total No. of relationships = n [2^n/2 + (n-1)]= 5 {25/2+(5-1)}=100

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.

Leadership and Motivation – Concepts and Theories

5.6

5.6.1 Leadership

Definition

As management itself consists in getting things done through others, therefore, the human beings can be called the most dynamic elements of management and the other factors of production remain just dormant. In an organization, direction means guiding, overseeing or looking at these human beings.

Directing the employees include:

(a) Supervising employees

(b) Leading employees

(c) Motivating employees

(d) Communicating with employees

Managers or supervisors at all levels act as leaders because they have under them subordinates whose efforts have to be organized and harmonized. Leadership is the process of directing and influencing task-related activities of group members. Leadership involves other people – subordinates or followers. Leadership involves an unequal distribution of power between leaders and group members. Leadership is the ability to use the different forms of power to influence followers' behaviour of ways. Leadership in another sense means the capacity of an individual to influence the thought and actions of others in some useful direction.

Leadership is essential for managing. The ability to lead effectively is one of the keys to being an effective manager because she/ he have to combine resources and lead a group to achieve objectives. Leadership has been defined by experts from time to time as follows:-

- According to Davis, "Leadership is the ability to persuade others to seek defined objectives enthusiastically. It is the human factor which binds a group together and motivates it towards goals".
- According to the Haimann, "Leadership is the process by which an executive imaginatively directs, guides and influences the work of others in choosing and attaining specified goals by mediating between the individuals and the organization in such a manner that both will obtain maximum satisfaction.
- According to Koontz and Donnell, "leadership is the ability of a manager to induce subordinates to work with confidence and zeal".

In essence, thus leadership may be defined in terms of totality of functions by managers as individuals and as a group. Leadership may be defined simply as influence, the art or process of influencing people so that they will strive willingly towards the realization of common goals. The essence of leadership is followership. Thus, leadership process is interplay of three elements-the leader, the follower and the situation.

Characteristics of Leadership

An analysis of the definitions of leadership brings out following characteristics of leadership:

(1) Leadership is a personal quality.

(2) Leadership presupposes the existence of a group of followers. There can be no leadership without followers.

(3) Leadership tries to influence the individuals to behave in a particular way. Successful leaders are able to influence the behaviour, attitudes and beliefs of the followers.

(4) Leadership arises out of functioning for a common goal.

(5) Leadership is a continuous process of influencing behaviour.

(6) Leadership is related to a particular situation at a given point of time under a specific set of circumstances. Thus, leadership style will be different under different circumstances.

Difference between Leadership and Management

Leadership and management are different from each other. Following are the points of distinction:

Leadership	Management
1. The focus of leadership is on leading people.	1. The focus of management is on managing work.
2. Leadership has leader-follower relationship.	2. Management has superior-subordinate relationship.
3. Leadership is a part of management and one of the managerial functions.	3. Management is the formal and organised groups.

Qualities of a Successful Leader

A leader must possess certain exemplary qualities by virtue of which he may be able to lead and guide his subordinates.

From a holistic perspective, the qualities which are necessary for a successful leader can be stated as follows:

(1) Physical energy and stamina: A leader should have a good personality, charming manners, and ability to work hard. A leader will be successful only when he acts with the group as a member and works hard. A leader can help a business enterprise to achieve its objectives or goals.

(2) Intelligence: Leaders should have somewhat higher intelligence than the average of their subordinates. They should possess the ability to think scientifically, analyse accurately and interpret clearly and concisely and problems faced by the group.

(3) Vision and foresight: A leader should exhibit his trait of looking forward. He must have foresight to see and feel the future. He should take into account the happenings which are about to occur in future. This will enable him to maintain his influence over his subordinates.

(4) Initiative: The main task of a leader is to initiate suitable sequence of actions in proper time. Hence, leaders must possess a strong, crucial motivation to keep accomplishing something.

(5) Self-confidence: Self-confidence is essential to motivate the subordinates and boost up their morale. He should have confidence in himself whenever he takes any decision or initiates any cause of action. For this a leader should have conceptual clarity about the things, he is going to do. a confused leader may cause damage to the group or organization.

(6) Open mindedness or flexibility: A leader should be flexible or open-minded, i.e., he should be ready to absorb

new ideas as may be demanded by the situation. He should be prepared to accommodate other's view points and alter his decision, if need be.

(7) Sense of responsibility: A leader should be prepared to shoulder the responsibility for the consequences of any steps he contemplates or takes. He should be aware of the duties and obligations associated with the position held by him.

(8) Human relations – a leader should possess the human relations attitude. He should be able to deal with people and secure their willing cooperation. He should try to develop social understanding with the people. He should try to achieve the voluntary cooperation of the subordinates.

Leadership Styles

Leadership styles/ types can be classified under the following categories:

(A) Leadership style based on the use of Authority

(B) Leadership Continuum, involving a variety of styles ranging from a maximum to a minimum use of power and influence

(C) Leadership styles described in Managerial Grid by Blake and Mouton

(D) Systems of management by Rensis Likert

(A) Based on Authority

On the basis of how leaders use their power, leadership styles can be classified into three broad categories –

- autocratic,
- participative and
- free-rein.

Autocratic or Authoritarian Leadership

An autocratic leader exercises complete control over the subordinates. He centralizes power in himself and takes all decisions without consulting the subordinates. He dominates and drives his group through coercion and command. He loves power and never delegates authority. The leader gives orders and expects the subordinates to follow them ungrudgingly and unquestioningly. He uses rewards and holds threat of penalties to direct the subordinates.

Advantages

(i) Autocratic leadership style permits quick decision making.

(ii) It provides strong motivation and satisfaction to the leader who dictates terms.

(iii) Less competent subordinates are needed at lower levels.

(iv) The style may yield positive results when promptness is required.

Disadvantages

(i) Autocratic style leads to frustration, low morale and conflict among subordinates.

(ii) Subordinates tend to shirk responsibility and initiative.

(iii) Full potential of subordinates and their creative ideas are not utilized.

(iv) Organisational continuity is threatened in the absence of the leader because a subordinate gets no opportunity for development.

Autocratic leadership style may be appropriate when subordinates are uneducated, unskilled and submissive. Lack of knowledge and experience on the part of subordinates make it necessary that the leader takes decisions himself. This style may also be desirable when the company endorses fear and punishment as accepted disciplinary techniques. When a leader prefers to be dominant in decision making and there is little room for error in final accomplishment, autocratic leadership may enhance morale and improve productivity.

Democratic or Participative Leadership

A consultative or democratic leader takes decisions in consultation and participation with the subordinates. He decentralizes authority and allows the subordinates to share his power. the leader does what the group wants and follows the majority opinion. He keeps the followers informed about matters affecting them. A democratic leader provides freedom of thinking and expression. He listens to the suggestions, grievances and opinions of the subordinates.

Advantages

(i) Consultative leadership improves the job satisfaction and morale of subordinates.

(ii) It cultivates the decision-making ability of subordinates.

(iii) The leader multiplies his abilities through the contribution of his followers,

(iv) It develops positive attitudes of the leader and reduces resistance to change.

(v) The quality of decisions is improved.

(vi) Labour absenteeism and labour turnover is reduced.

Disadvantages

(i) Democratic style is time-consuming and may result in delays in decision-making.

(ii) It may not yield positive results when subordinates prefer minimum interaction with the leader.

(iii) Over a period of time subordinates may develop the habit of expecting to be consulted.

(iv) Consultation may be interpreted as a sign of incompetence on the part of the leader to deal with problems.

(v) It may be used as a means of passing the buck to others and abdicating responsibility.

(vi) It requires considerable communicating and persuasive skills on the part of the leader.

Participative leadership is considered to be more effective than autocratic style though there is no empirical-proof for this. Consultative style is more compatible with the prevailing value system which favours freedom of expression and independent thinking. The choice of leadership style depends upon the immediate goal and on the subordinates. if the immediate goal is increase in productivity or subordinates have low need for independence, autocratic style may be preferable. But when the goal is job satisfaction and employees have a high need for independence, consultative style may be more effective. Consultative style is also appropriate where subordinates have accepted the goals of the organisation and the leader really wants to share decision-making with the subordinates.

Free-rein or Laissez-Fair Leadership

Free-rein leadership involves complete delegation of authority so that subordinates themselves take decisions. The free rein leader avoids power and relinquishes the leadership position. He serves only as a contact to bring the information and resources needed by the subordinates.

Advantages

(i) Positive effect on job satisfaction and morale of subordinates.

(ii) Maximum possible scope for development of subordinates,

(iii) Full utilization of the potential of subordinates.

Disadvantages

(i) Subordinates do not get the guidance and support of the leader.

(ii) it ignores the leaders' contribution just as autocratic style ignores the contribution of the subordinates.

(iii) Subordinates may move in different directions and may work at cross purposes which may degenerate into chaos.

Free rein style may be appropriate when the subordinates are well trained, highly knowledgeable; self motivated and ready to assume responsibility.

(B) Based on Leadership Continuum

Tannenbaum and Schmidt have developed the concept of leadership continuum to highlight the range of possible leadership styles. at the left end of the continuum there is 'boss centered' (autocratic) leadership style while at the right end is the 'subordinate centered' (free-rein) - style. As one move from the left extreme to the right extreme, the degree of control goes down and the freedom of subordinates goes up.

1. Manager makes decision and announces it. It is an extreme form of autocratic leadership whereby the boss takes the decision and asks the subordinates to implement it.
2. Manager sells the decision. In this style the boss alone takes the decision and persuades the subordinates to accept it.
3. Manager presents ideas and invites questions. This style involves greater involvement of subordinates. The boss arrives at the decision and asks subordinates to express their views on it.
4. Manager presents tentative decision subject to change. Herein the boss takes a. tentative decision and modifies it in the light of views expressed by the subordinates.
5. Manager presents problems, gets suggestions and takes decision. In this case the boss takes the decision after hearing the suggestions from subordinates.
6. Manager defines the limits and asks the group to make decision. Under this style of leadership the boss gives the freedom to subordinates to take decision subject to predetermined limits.
7. Manager permits subordinates to function within the limits defined by him. This style involves full participation of subordinates. The boss defines overall limits. Subordinates are free to decide and act within these limits.

The continuum approach to leadership provides a wide range of leader behaviors. It identifies the behavioural alternatives available to a manager and highlights the dynamic nature of leadership. It also suggests that the leadership style should be adapted to the requirements of the particular situation.

While choosing the appropriate style, a manager should consider the following factors –

1. Forces in the manager - Manager's value system, his confidence in the subordinates, his leadership inclinations and his tolerance of ambiguity.
2. Forces in the subordinates - subordinates' need for independence, their tolerance for ambiguity, their willingness to assume responsibility for decision making, their interest in and understanding of problems,

their understanding of and identification with organisational goals their experience with and expectations of leadership.

3. Forces in the situation - type of organisation, nature of problems, group effectiveness, time pressure, etc.

(C) Leadership Styles in Managerial Grid

The managerial grid leadership style is developed by Robert Blake and Jane Mouton. The grid has two dimensions -concern for people and concern for production. Concern for people may include such elements as provision of good working conditions, placement of responsibility on the basis of trust rather than obedience, maintenance of self-esteem of workers and good interpersonal relations.

Concern for production may also include the attitudes of a supervisor toward a wide variety of things, such a quality of staff services, work efficiency, volume and quality of output etc. The bi-dimensional managerial grid identifies a range of management behaviours based on the various ways that task-oriented and employee-oriented styles (each expressed as a continuum on a scale of 1 to 9) can interact with each other in Figure 1 below:

Figure 1 : Managerial Grid

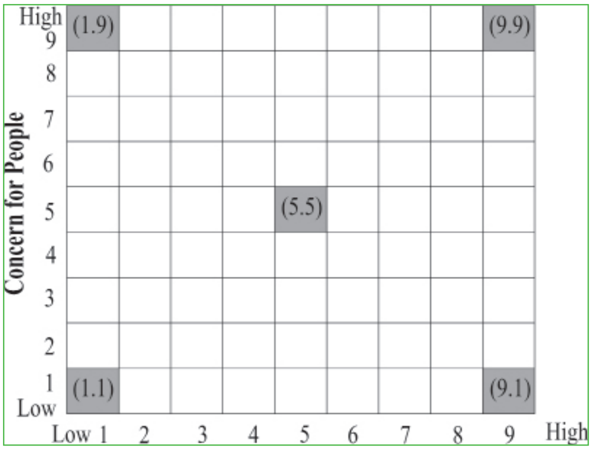


Figure 5.5 : Concern for Production

Source: J.A.F. Stoner, R.E. Freeman and D. R. Gilbert. Jr. "Management", Sixth Edition, p.475.

The styles are follows:

1) Style (1,1)- The Impoverished or the Indifferent (Low Production / Low People): It is a lazy approach. The leader-manager shows low concern for both production and people. It is delegate-anddisappear type of leadership.

2) Style (1, 9) -Country Club (Low Production / High People): This style is a one-sided approach where the leader-manager pays much attention to the security and comfort of the employees but he has low concern for production.

3) Style (9,1)- Produce, Dictatorial or Perish (High Production / Low People): It is an authoritarian leadership style where the leader-manager finds employee needs unimportant, and pressurizes employees through fear and punishments. But he has high concern for production.

4) Style (9, 9)- The Team or Sound (High Production / High People): In this style, the leader-manager pays high concern to both people and production.

5) Style (5, 5) - The Middle-of-the-road or the Status-quo (Medium Production / Medium People): The leader-manager in this style tries to balance between the competing goals of the organization and the needs of the workers

(D) Likert's System of Management

Rensis Likert and his associates of the University of Michigan, U.S.A. conducted an extensive survey of management style and patterns in large number of organizations. Likert developed a continuum of four system of management. These systems indicate the stages of evolution in the patterns of management in organisations. These are based on several variables namely leadership, motivation, communication, interaction, influence, decision- making process, goal-setting and control process. A brief description of the Likert's four management systems is given below -

System 1 - Exploitative autocratic– The managers under this system make all work- related decisions and order their subordinates to carry out the decisions. The managers also define standards and methods of performance. The subordinates have absolutely no say in the decision-making process. The communication between the manager and his subordinates is highly formal in nature and downward in direction. Such managers believe in threats and punishments to get things done. They exercise strict supervision and control over the subordinates.

System 2 - Benevolent autocratic– System 2 managers are also autocratic but they are not exploitative. They adopt a paternalistic approach towards the subordinates. They allow some freedom to subordinates to carry out their tasks within the prescribed limits. the managers adopt patronizing attitudes towards the obedient and faithful subordinates. they are rewarded for accomplishment of goals. But the subordinates who do not their tasks are treated harshly. thus carrot and stick approach to motivation is adopted under this system.

System 3 - Consultative– Managers under this system set goals and issue orders after discussing them with the subordinates. They take major decisions themselves and allow subordinates to take the routine decisions. Subordinates are free to discuss the work-related matters with the managers. Thus there is two-way communication in the organisation. Managers' trust subordinates to carry out their tasks. Greater emphasis is placed on rewards than on penalties to motivate the subordinates. The control system tends to be goal-oriented and flexible.

System 4 - democratic– Under this system, goals are set and work related decisions are taken by the subordinates. Supervision and control are group- oriented. Managers are friendly and supportive in their attitudes towards the subordinates. Subordinates are permitted self-appraisal on the basis of mutually set goals. In addition to economic rewards, subordinates are given a sense of purpose and feeling of worth. The communication system is completely open. Likert suggested that system 4 is the ideal system towards which organizations should Work.

Contingency or Situational Approach to Leadership

It is clear from the foregoing description that leadership is a product of many forces that act and interact simultaneously. Every manager must achieve some degree of integration of these varying and complex forces otherwise a void in his leadership may arise. An integrated model of leadership has been proposed by George Terry.

Leadership consists of four main variables:

1. The Leader: Leader's personal values (deep beliefs and convictions) shape his perceptions and behaviour. Leader's confidence in the group members, extent of power sharing and genera! circumstances the leader prefers are important characteristics. Leader's awareness of self is also significant.
2. The Followers The forces within the followers include identification with the leader's objectives, interest and involvement in solving problems, knowledge and experience, need for independence, etc.
3. The Organisation: Nature and type of organisation exercise significant influence on leadership. When the degree of interdependence between specialised units is high, lateral relationships are essential for coordination. this is because the followers tend to centre their attention in their own work and do not see the impact of their

actions on others. Similarly, Technology governs the degree to which the task is structured. in case of highly structured tasks, the leader has more influence because, employees' work behaviour is specified and major decisions are centralised. Standard operating instructions and detailed manuals are provided and little is left for the group members to decide. When the task is uncertain a permissive and passive leadership tends to be more effective because exact make-up of work is unknown.

4. The Environment: Leadership should be in harmony with the external environment. Social values, economic and political conditions, etc., bring about changes that lead to a redefinition of acceptable and effective leadership.

Servant Leadership

While servant leadership is a timeless concept with a strong citation in the Vedantic speech of Swami Vivekananda during late years of nineteenth century, the phrase "servant leadership" was coined by Robert K. Greenleaf in The Servant as Leader, an essay that he first published in 1970. In that essay, Greenleaf said:

"The servant-leader is servant first… It begins with the natural feeling that one wants to serve, to serve first. Then conscious choice brings one to aspire to lead. That person is sharply different from one who is leader first, perhaps because of the need to assuage an unusual power drive or to acquire material possessions…The leader-first and the servant-first are two extreme types. Between them there are shadings and blends that are part of the infinite variety of human nature.

A servant-leader focuses primarily on the growth and well-being of people and the communities to which they belong. While traditional leadership generally involves the accumulation and exercise of power by one at the "top of the pyramid," servant leadership is different. The servant-leader shares power, puts the needs of others first and helps people develop and perform as highly as possible.

Principles of Servant Leadership

- Encourage diversity of thought.
- Create a culture of trust.
- Have an unselfish mindset.
- Foster leadership in others.

Therefore, the following aspects of 'Servant Leadership' can be made germane in the present day. These aspects may further raise some eternal questions that prevail across the manager's fraternity. Some of them are listed below:

- Qualities of a servant leader: A servant leader has to have empathy. Compassion towards fellow workers is the ultimate criteria for being a servant leader. 'Servant leadership' states that a leader should always remember that he is a servant because he is the leader and a leader because he serves. Self-obsession and hunger for power have no room in servant leadership.
- Effect of such leadership on work performance: Servant leadership has a great effect on how work is done in any organization and how the entire work culture of the organization operates. It is quite different from other styles of leadership.
- Effect on the overall life of an employee: The overall life of the employees is also affected through servant leadership. The way he or she looks towards other aspects of life would change when he or she works under a servant leader. If most of the leaders in the corporate world had been servant leaders, the business world would not have faced the current epidemic of corporate stress. Every year several companies across the globe spend millions of dollars for the treatment of employee stress to regain productivity.

Leadership Effectiveness

In business enterprises, managers at various levels, assume the role of leadership in relation to their subordinates for getting the right things done in a proper manner to achieve a certain set of goals. the effectiveness of managers as leaders is critical to organisational survival and success. Hence there is a high premium on leadership effectiveness in business enterprises.

There are at least three major views on the determinants of leadership effectiveness. one view is that effectiveness is a function of the personal qualities or traits of the individuals who assume the role of leadership.

The second view is that leadership effectiveness is a matter of what leaders do and how they behave. This is known as the behavioural approach. the two most important dimensions of the behaviour of leaders are productivity orientation and employee satisfaction orientation.

The third view is that leadership effectiveness is a function of interaction among at least three variables:

the leader, the group of followers and the tasks situations. This is known as the situational or contingency approach to leadership as discussed earlier.

On a careful examination of the above discussed three views on the determinants of leadership effectiveness, following observations can be made:

(a) Effective leadership requires certain basic qualities among persons who assume the role of leaders. These are necessary but not sufficient.

(b) There is no ideal leadership style or behaviour generally applicable for all situations. Leadership effectiveness can be secured or enhanced by tailoring the style to the demands of each situation.

(c) The important situational factors which exert considerable influence on leadership effectiveness are:

- task complexities,
- the skills and attitudes of the group of followers,
- their relations with the leader and
- the position power of the leader himself.

Measures for developing Leadership Ability of Managers

It is at once necessary and possible for managers to develop and improve their leadership abilities. It is necessary because managers have to get things done through their subordinates. They will be able to get things done effectively if they have leadership ability. It is possible because they are several means and techniques of acquiring leadership abilities. Also, leadership abilities are not totally inborn or genetic. They can be acquired and learnt by training and by other means. The measures for developing leadership ability of managers are explained as follows:

(a) Leadership training: Training programmes are offered to expose managers to several leadership situations and teach them how to tackle them. The Situations are partly simulated and partly real. The trainers create the situations wherein the managers undergoing leadership training are provided opportunities to diagnose problems, think of ways and means of tackling them which partly involve testing of various styles of leadership against realities. Leadership training gives insights and experiences of managers on appropriate attitudes and behaviour which they have to adopt in tackling diverse situations, on how to gain initiative and command over a situation how to inspire and motivate people, that measures are necessary to inject discipline, cohesiveness and team work ethic in the group, and so on. The managers under training are to be given immediate feedback on their leadership performance.

(b) Internal organisational exposure: Another measure to develop the leadership ability of managers is to expose them within the organisation itself to critical situations calling for application of leadership abilities. Managers may be put in charge of committees assigned with the task of project implementation, coordination and control. Managers may also be placed in situations concerning people's problems - for example, how to improve the lowered morale of a work group, how to resolve internal conflict, how to induce a sense of involvement of work groups in the organisation and so on.

(c) Autonomy and accountability: Managers may be able to sharpen their leadership abilities under conditions of relative freedom. They should be allowed a large amount of freedom to evolve their own methods of tackling situations calling for critical leadership abilities. at the same time they should be provided with the required organisational support in the form of authority (position power), status, and top management support and so on. They should be given adequate discretion dispensing rewards and penalties to their subordinates, within the framework of certain norms and rules.

(d) Opportunities for interaction: Managers should also have opportunities to interact with their subordinates in a more intense and continuous manner. This is partly a matter of availability to time. Many managers get themselves so extremely busy with their own work that they find little time to talk or listen to their subordinates, to guide them, to understand their viewpoints, to be supportive to them and to develop them.

5.6.2 Motivation

Definition

The term 'motivation' has been derived from the word 'motive'. Motive means the urge to do something. Motivation may be defined as the process of inducing or inspiring people to take the desired course of action.

According to Stephen Robbins, "Motivation is the willingness to exert high levels of effort towards organisational goals, conditioned by the efforts ability to satisfy some individual needs."

The process of motivation begins with the awareness of a need. Feeling of an unsatisfied need causes tension. A person takes some action to satisfy his need. If the action succeeds to satisfy the need, the person feels motivated. In case the action fails, the person takes a different action. When the present need is satisfied, a new need arises and the process is repeated.

Thus, motivation involves interaction between needs and incentives. Incentives are the inducements which are used to motivate people. An incentive has motivational power because it helps to satisfy some need. Several financial and non-financial incentives are used to motivate people.

On the basis of the above description, the following characteristics of motivation can be identified:

1. Motivation is a psychological concept: It is based on human needs which generate within an individual. Needs are feelings in the mind of a person that he lacks certain things. Such feelings influence the behaviour and activities of the individual.

2. Motivation is total, not piece-meal: A person cannot be motivated in parts. An employee is an indivisible unit and his needs are interrelated. He cannot be motivated by fulfilling some of his needs partly.

3. Motivation is a continuous process: It is not a time bound programme or a touch-and- go affair. Human needs are infinite. As soon as one need is satisfied new ones arise. In the words of McGregor, "man is a wanting animal, as soon as one of his needs is satisfied another appears in its place. This process is unending." satisfaction of one need gives feeling of another and the process continues.

4. Motivation causes goal-directed behaviour: A person behaves in such a way that he can satisfy his goals or needs. A person will work so long as he feels his actions are fulfilling his strongly felt needs. He will not pursue-the activity and will lose interest in his work if he feels that it is not satisfying his needs.

5. Motivation may be financial or non-financial: The form of motivation depends upon the type of needs. Financial incentives include pay, allowances, bonus and perquisites. Non- financial incentives consist of recognition, praise, responsibility, participation in decision- making, challenging job, etc.

6. Motivation is a complex process: There is no universal theory or approach to motivation. Moreover, individuals differ in what motivates them. Therefore, a manager has to analyse and understand a variety of needs and has to use a variety of rewards to satisfy them. He should not expect overnight results.

Importance of Motivation

Motivation is one of the most crucial factors that determine the efficiency and effectiveness of an individual in organisation. All organisational facilities will remain useless unless people are motivated to utilise these facilities in a productive manner. Motivation is an integral part of management process and every manager must motivate his subordinates to create in them the will to work. High motivation provides the following advantages:

1. **Higher efficiency:** Motivation is an effective instrument in the hands of management to maximize efficiency of operations. A worker may be very competent but no activity can take place until the individual is willing to perform that activity. What employees do depends largely on how much and why they want to do. Motivated employees give greater performance than demotivated ones.

2. **Optimum utilisation of resources:** Motivation inspires employees to make best possible use of different factors of production. They work wholeheartedly to apply their abilities and potential in minimizing waste and cost. The enterprise can make maximum use of its physical and financial resources.

3. **Reduction in labour turnover:** High motivation leads to job satisfaction of workers. Opportunities for need satisfaction make employees loyal and committed to the organisation. as a result labour absenteeism and turnover are low.

4. **Better industrial relations:** Increased labour productivity in turn results in higher wages for employees. Motivational schemes create integration of individual interests with organizational objectives. There arises a sense of belonging and mutual co-operation at all levels. Motivation will foster team spirit among workers. This will reduce labour unrest and create better relations between management and workers.

5. **Easier selection:** An enterprise that offers abundant financial and non-financial incentives enjoys reputation in the labour market. Therefore, it can easily attract competent persons for filling various vacancies.

6. **Facilitates change:** High motivation helps to reduce resistance to change. an organisation has to incorporate changes to cope with environmental changes. Properly motivated employees accept, introduce and implement these changes keeping the organisation effective.

Theories of Motivation

There are several theories of motivation. Some are called content theories and others are called process theories. These theories can be summed up as under:

1. Maslow's Need Hierarchy Theory
2. Herzberg's Two-Factory Theory
3. Theory X and Theory Y by McGregor
4. Alderfer's ERG (Existence, Relatedness and Growth) Theory
5. Achievement Motivation Model by Mcclelland
6. J. Stacy Adam's Equity Theory

7. Victor Vroom's Expectancy Theory

1. Maslow's Model

Abraham H. Maslow, an eminent American psychologist, developed a general theory of motivation, known as the 'Need hierarchy theory'. The salient features of this theory are as follows:

(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.

1. **Physiological needs:** These are biological needs required to preserve human life. Therefore, these needs are also known as survival needs. They include needs for food, drink, air, sleep, etc. these needs must be satisfied first of all and, therefore, they are a powerful motivating force when thwarted. 'Man lives by bread alone' when there is no bread. Physiological needs must be satisfied repeatedly but they are essentially finite. For example, an individual requires a limited amount of food but he requires it every day.

2. **Safety needs:** Once physiological needs are reasonably satisfied; a person wants protection from physical dangers and economic security. Safety needs are thus concerned with protection from danger, deprivation and threat. These needs are finite but they may serve as motivators in case of arbitrary and unpredictable management actions. Such actions create uncertainty and people seek job security. Organisations can influence these needs through pension schemes, insurance plans, fear of dismissal, etc.

3. **Social needs:** Man is a social animal as he seeks affiliation (association) with others. Social needs refer to need for belonging, need for acceptance, need for love and affection, etc. such needs are infinite as they are considered as secondary needs because they are not essential to preserve human life. They represent needs of the mind and spirit rather than of the physical body. Organisations can influence these needs through supervision, communication system, work groups, etc.

4. **Esteem needs:** Esteem needs are of two types: self-esteem and esteem of others. Self-esteem needs include self-respect, self-confidence, competence, achievement, knowledge and independence. Esteem of others includes reputation, status, and recognition. These needs are infinite and thwarting them results in feelings of inferiority, weaknesses and helplessness.

5. **Self-actualization needs:** These are the needs for realising one's full potential, for continued self-development, for being creative. It is the desire of becoming what one is capable of becoming. it is an infinite and growth need. It is psychological in nature and very few persons satisfy it. The conditions of modern industrial life

provide limited opportunity for the satisfaction of self-actualisation?

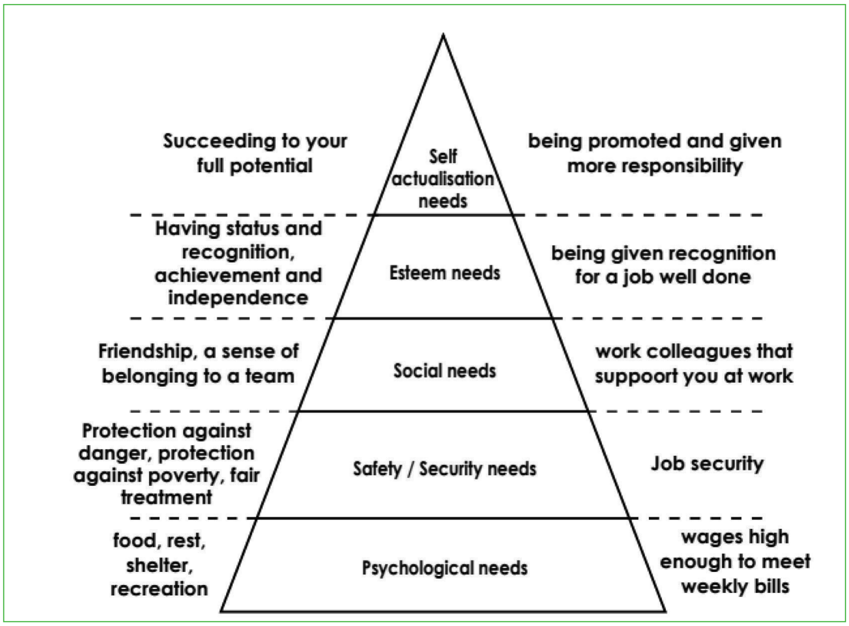


Figure 5.6: Abraham Maslow's Hierarchy Theory

Adopted from: "Maslow's Hierarchy : Applications for the workplace"

Evaluation: Need hierarchy represents a typical pattern that operates most of the time. It must not be viewed as a rigid structure to be applied in all situations.

Maslow's need priority model of motivation has gained extensive popularity because it is simple and logical. It is compatible with the economic theory of demand. The theory helps to explain why a person behaves differently in two similar situations. It provides an insight into what is common to all. It extends to all areas of human life and is not limited to work situation alone. But there is little empirical support for it because its propositions could not be vigorously tested through empirical research. The theory could not be validated but it is said to contain some fundamental truths which do not require any proof.

However, the theory is widely criticised for the following reasons:

(i) Needs are not the only determinant of behaviour. People seek objects and engage in behaviour that is in no way connected with the gratification of needs. There are other motivating factors like perceptions, expectations, experiences, etc.

(ii) The theory gives an over simplification of human needs and motivation. Need recognition and fulfilment do not always follow the specific sequence of hierarchy suggested by Maslow, Need classification is somewhat artificial and arbitrary as human needs cannot be classified into neat watertight compartments. Therefore, the theory may not have universal validity.

(iii) The hierarchy of needs is not always fixed. Different people may have different orders. For example, in case of creative people like singers, painters, etc., self-actualisation need may become a dominant motivating force even before the lower order needs are satisfied. Similarly, the need priorities of the same individual may change over time. As a result, a manager cannot keep up with a continuously revolving set of needs. Thus, Maslow's model presents a somewhat static picture of need structure. The theory does not recognise individual differences. Individuals differ in the relative intensity of their different needs.

(iv) Maslow's theory is based on a relatively small sample. it is a clinically derived theory and its unit of analysis is the individual. That is why Maslow presented his model with apologies to those who insisted on conventional reliability, validity, sampling, etc.

(v) There is no definite evidence that once a need is satisfied it loses its motivating force. It is also doubtful that satisfaction of one need automatically activates the next need in the hierarchy.

Some persons will not aspire after their lower-order needs have been satisfied. Human behaviour is the outcome of several needs acting simultaneously.

The same need may not lead to the same response in all individuals. Similarly, one particular behavior may be the result of different needs. There is lack of direct cause and effect relationship between need and behaviour.

Despite these limitations, Maslow's theory has a common sense appeal for managers. It is still relevant because needs are important for understanding behaviour. The theory provides a convenient conceptual framework for the study of motivation. It helps to explain inter-personal and intra-personal differences in human behaviour.

2. Herzberg's Model

In the late fifties, Frederick Herzberg and his associates conducted interviews of 200 engineers and accountants in the Pittsburgh area of the United States. These persons were asked to relate elements of their jobs which made them happy or unhappy. An analysis of their answers re-veiled that feelings of unhappiness or dissatisfaction were related to the environment in which people were working. On the contrary, feelings of happiness or satisfaction were related to their jobs.

According to Herzberg, maintenance or hygiene factors are necessary to maintain a reason- able level of satisfaction among employees. These factors do not provide satisfaction to the employees but their absence will dissatisfy them. Therefore, these factors are called dissatisfiers. These are not intrinsic parts of a job but they are related to conditions under which a job is performed. They are environmental factors (extrinsic to the job) and are given in the following table:

Maintenance Factors	Motivating Factors
Company Policy and Administration	Achievement
Technical Supervision	Recognition
Inter-personal relationship with peers	Advancement
Inter-relationship with supervisors	Opportunity for growth
Inter-relationship with subordinates	Responsibility
Salary	Work itself
Job Security	
Working conditions status	

On the other hand, motivational factors are intrinsic parts of the job. Any increase in these factors will satisfy the employees and help to improve performance. But a decrease in these factors will not cause dissatisfaction.

Herzberg noted that the two sets of factors are uni-dimensional, i.e. their effect can be seen in one direction only. He admitted that the potency of any of the job factors is not solely a function of the nature of the factor itself. it is also related to the personality of the individual who may be either a 'motivation seeker' or a 'maintenance seeker'. a motivation seeker is motivated primarily by the nature of the task and has high tolerance for poor environmental factors. On the other hand, maintenance seeker is motivated primarily by the nature of his environment and tends to avoid motivation opportunities.

He is dissatisfied with maintenance factors surrounding the job. He shows little interest in the kind and quality of work.

Herzberg's theory has received a great deal of attention and it has become popular among managers. One striking conclusion of Herzberg's theory is that one cannot achieve higher performance simply by improving wages and working conditions. The conclusion should be an eye opener to managers who go on improving wages and fringe benefits with the hope of improving efficiency.

Herzberg stressed upon the job as an intrinsic motivating factor. The key to job satisfaction and high performance lies in job enrichment. Herzberg's two factor theory has made a significant contribution towards improving manager's basic understanding of human behaviour. His theory is simple and based on empirical data. It offers specific actions for managers to improve motivation and performance. This theory has exercised tremendous impact in stimulating thought, research and experimentation in the area of work motivation.

Traditionally, job satisfaction and dissatisfaction were viewed as opposite ends of a single continuum. Herzberg's findings indicate that dissatisfaction is not simply the opposite of satisfaction or motivation. Satisfaction and dissatisfaction are independent rather than opposite ends of the same continuum.

Motivating Factors

Satisfaction (Motivation) ←——→ No Satisfaction (No Motivation)

Hygiene Factors

Dissatisfaction (Motivation) ←——→ No Satisfaction (No Motivation)

Criticisms of the theory – Herzberg's theory has been criticised on the following grounds:

(i) The theory is based on a small sample of 200 accountants and engineers which is not representative of the work force in general. Other researchers have drawn different results from similar studies. The theory is most applicable to knowledge workers. Studies of manual workers are less supportive of the theory. Therefore, the theory is not universally applicable.

(ii) Herzberg's model is method bound and is limited by the critical incident method used to obtain information when satisfied people attribute the causes of their feelings to themselves. When they are dissatisfied they attribute their failures to outside forces. People tend to tell the interviewer what he would like to hear rather than what they really feel. The interview method used by Herzberg suffers from bias. The approach is highly subjective. Therefore, the empirical validity of the theory is doubtful.

(iii) The theory focuses too much attention on satisfaction rather than on performance level. There is no direct link between satisfaction, motivation and performance. Therefore, Herzberg's two factor theory is an oversimplified presentation of the process of motivation.

(iv) The distinction between maintenance factors and motivating factors is not fixed. The same factor may be motivating for some people and maintenance factor for other people.

Comparison of Maslow and Herzberg theories –

Herzberg's theory is an extension of Maslow's need priority model. The two models are basically compatible or complementary. There is a close similarity between survival needs (physiological, safety and social needs and dissatisfaction) and dissatisfiers on the one hand and between growth needs (esteem and self-actualization needs) and satisfiers on the others.

Both Maslow and Herzberg models tend to over-simplify the motivational process. Maslow's model is formulated in terms of human needs while Herzberg's model is in terms of rewards or goals. Herzberg has attempted to refine and reinforce on the need priority model and has thrown a new light on the content of work motivation.

The two models show marked similarities as shown below:-

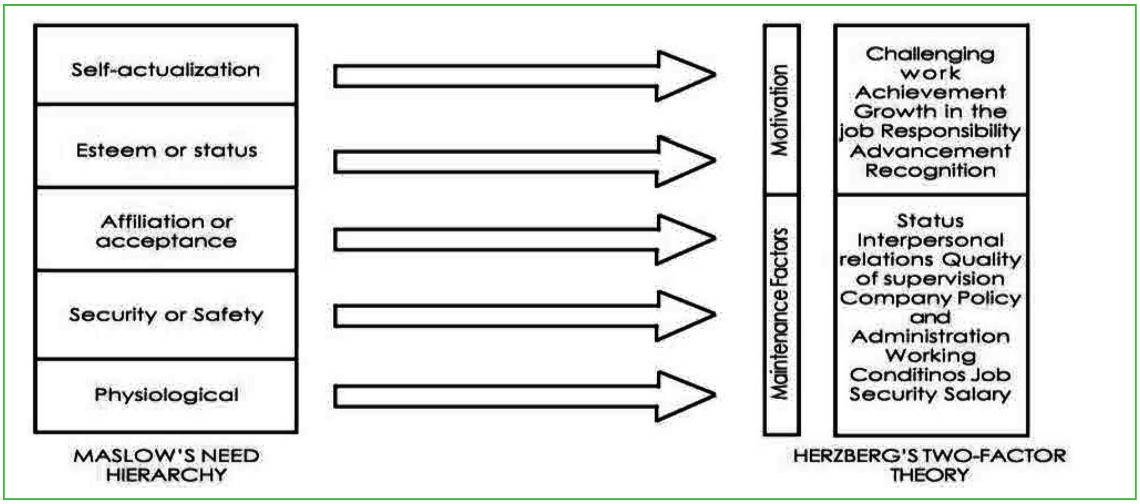


Figure 5.7 Similarity between Maslow & Herzberg Theory

3. McGregor's Model

Prof. Douglas McGregor has developed a theory of motivation on the basis of hypotheses relating to human behavior. According to McGregor, the function of motivating people involves certain assumptions about human nature. There are two alternative sets of assumptions which McGregor has described as theory X and theory Y.

Theory X – Theory X of motivation is based on the following assumptions:

1. The average individual is by nature indolent and will avoid work if he can.
2. The average person lacks ambition, dislikes responsibility, and prefers to be led.
3. An average human being is inherently self-centred, and indifferent to organisational goals.
4. Most people are by nature resistant to change and want security above all.
5. The average individual is gullible, not very bright, the ready victim of the schemer.

On the basis of these assumptions, the conventional view of management puts forward the following propositions:

1. Management is responsible for organising the elements of productive enterprise—money, materials, equipment, people—in the interest of economic gain.
2. With respect to people, management involves directing their efforts, motivating them, controlling their actions and modifying their behaviour to fit the needs of the organisation.
3. Without active intervention by management, people would be passive – even resistant to organizational needs. They must, therefore, be persuaded, rewarded, punished and controlled.

The above assumptions are negative in nature. Therefore, theory X is a conventional or traditional approach to motivation. External control is considered appropriate for dealing with unreliable, irresponsible and immature people. According to McGregor, an organisation built upon theory 'X' notions will be one in which there is close supervision and control of subordinates and high centralization of authority. Leadership in such an organisation will tend to be autocratic, and workers will have very little (if any) say in decisions affecting them. The climate in a theory X organisation would be impersonal—this theory implies use of 'carrot and stick approach'.

Theory Y – theory X is based on a faulty conception of human nature. McGregor recognised certain needs that Theory X fails to take into account. These relate to self-fulfilment, ego satisfaction and the social needs of individual workers. To meet these human needs in business, McGregor suggested a counter approach to management which he called Theory Y. The theory proposes that:

1. Management is responsible for organising the elements of productive enterprise in the interest of economic and social ends.
2. People are not by nature passive or resistant to organisational needs. They become so as a result of experience.
3. Motivation, potential for development, capacity for assuming responsibility and readiness to direct behaviour toward organisational goals are present in people, management does not put them there. it is the responsibility of management to make it possible for people to recognise and develop these characteristics for themselves.
4. The essential task of management is to arrange organisational conditions and methods of operations so that people can achieve their own goals best by directing their own efforts towards organisational goals.

Theory Y is based upon the following assumptions:

1. The expenditure of physical and mental effort is as natural as play and rest. The average human being has no inherent dislike for work. Work, if meaningful, should be a source of satisfaction and it can be voluntarily performed.
2. Man will exercise self-control "and self-direction in the service of objectives to which he is committed. External control or threat of punishment is not the only means of motivating people to work and achieve organisational goals.
3. Commitment to objectives is a result of the rewards associated with their achievement. The most significant of such rewards, e.g., the satisfaction of ego and self-development needs, can be the direct result of effort directed towards the organisational objectives. Once the people have selected their goal, they will pursue it even without close supervision and control.
5. The average human being, under proper conditions, does not shun responsibility. He is ready not only to accept responsibility but also to seek it. Avoidance of responsibility, lack of ambition, etc., are consequences of experience rather than being inherent in human nature.
6. The capacity to exercise a relatively high degree of imagination, ingenuity and creativity in the solution of organisational problems is widely, not narrowly, distributed in the population.
7. Under conditions of modern industrial life, the intellectual potentialities of people are only partially utilised. In reality, people have unlimited potential.

Comparison between Theory X and Theory Y:

Theory X	Theory Y
1. Inherent dislike for work	1. Work is natural like rest or play.
2. Unambition and prefer to be directed by others.	2. Ambition and capable of directing their others own behaviour.

3. Avoid responsibility.	3.Accept and seek responsibility under proper conditions.
4. Lack creativity and resist change	4. Creativity widely spread.
5. Focus on lower level (Physiological and safety)	5. Both lower level and higher order needs need to motivate workers like social; esteem and elfactualisation are sources of motivation.
6. External control and close supervision required to achieve organisational objectives.	6. Self-direction and self-control.
7. Centralisation of authority and autocrat leadership	7.Decentralisation and participation in leadership decision-making. Democratic leadership.
8. People lack self-motivation	8. People are self-motivated.

Theory Y represents a modern and dynamic nature of human beings. It is based on assumptions which are nearer to reality. An organisation designed on the basis of theory Y is characterised by decentralisation of authority, job enrichment, participative leadership and two-way communication system. The focus is on self-control and responsible jobs. Theory X places exclusive reliance on external control of human behaviour while Theory Y relies on self- control and self-regulation. "This difference is the difference between treating people as children and treating them as mature adults. After generations of the former we cannot expect to shift to the latter overnight."

McGregor's theory of motivation is simple. it helps to crystallize and put into right perspective the findings of the Hawthorne Experiments. It has generated wide ranging and lasting interest in the field of motivation. This theory offers a convenient framework for analysing the relationship between motivation and leadership style.

Despite its significance, McGregor's theory has been criticised for various reasons.

- First, it tends to over-generalise and over-simplify people as being one way or the other. People cannot be put into two extreme patterns or stereotypes.
- Secondly, McGregor's theory squeezes all managerial styles and philosophies into two extremes of conduct which is devoid of reality.
- Thirdly, McGregor suggests tacitly that job itself is the key to motivation. But all persons do not look for motivation in the job and not all work can be made intrinsically challenging and rewarding.
- Lastly, some managers may have Theory Y assumptions about human nature, but they may find it necessary to behave in a very directive and controlling manner with some people in the short run to help them grow up in a developmental sense until they are truly Y people.

A question often posed is which theory (X or Y) is better. Most people believe that theory Y is more desirable and productive. But it may not be the best approach for all situations. Theory X might be more suitable in some crisis situations but less appropriate in more routine and formalised situations: In some under-developed countries like India Theory X may still be useful at the lower levels of organisation.

4. Alderfer's ERG (Existence, Relatedness and Growth) Theory

Clayton Paul Alderfer, an American psychologist, developed ERG theory that suggests that there are three groups of core needs: existence (E), relatedness (R), and growth (G)—hence the acronym ERG. These groups align with Maslow's levels of physiological needs, social needs, and self-actualization needs, respectively.

Existence needs concern our basic material requirements for living. These include what Maslow categorized as physiological needs (such as air, food, water, and shelter) and safety-related needs (such as health, secure employment, and property).

Relatedness needs have to do with the importance of maintaining interpersonal relationships. These needs are based in social interactions with others and align with Maslow's levels of love/belonging-related needs (such as friendship, family, and sexual intimacy) and esteem-related needs (gaining the respect of others).

Finally, growth needs describe our intrinsic desire for personal development. These needs align with the other portion of Maslow's esteem-related needs (self-esteem, self-confidence, and achievement) and self-actualization needs (such as morality, creativity, problem-solving, and discovery).

Alderfer proposed that when a certain category of needs isn't being met, people will redouble their efforts to fulfil needs in a lower category. For example, if someone's self-esteem is suffering, he or she will invest more effort in the relatedness category of needs.

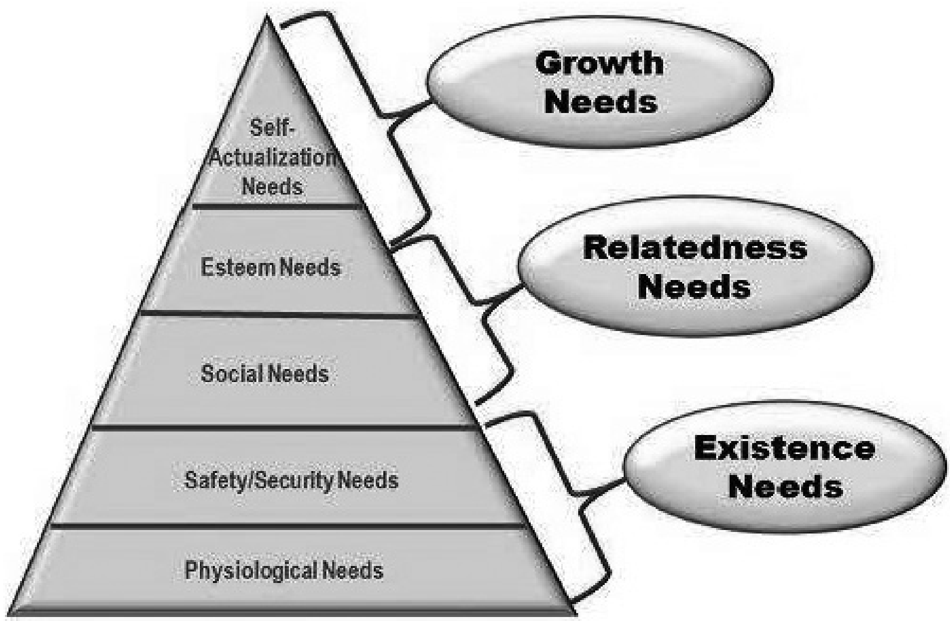


Figure 5.8 : Alderfer's ERG (Existence, Relatedness and Growth) Theory

5. Achievement Motivation Model by Mcclelland

David C. McClelland, an American psychologist had developed need theory on motivation and observed that three needs motivates human behavior that is power, affiliation and achievement. McClelland believed that each person has a need for all three and other needs but that people differs in the degree to which the various needs motivate their behavior.

These needs are:

- Need for achievement (n-Ach)
- Need for power (n-Pow)

- Need for affiliation (n-Aff)

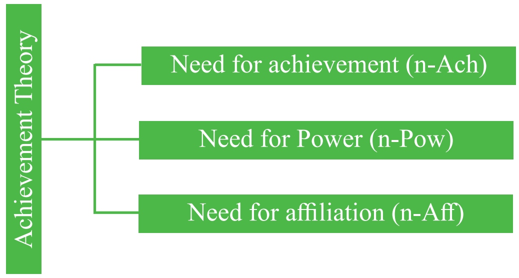


Figure 5.9 Motivation Model by Mcclelland

1. Need for Achievement (n Ach):- The need for achievement would fall between needs for esteem and self actualization. This need is satisfied not by the manifestations of success, which confer status, but with the process of carrying work to its successful completion. This is the drive to excel, to achieve in relation to a set of standard, and to strive to succeed. In other words, need for achievement is a behavior directed towards competition with a standard of excellence. McClelland found that people with a high need for achievement perform better than those with a moderate or low need for achievement and noted regional/national differences in achievement motivation. Through his research, McClelland identified the following three characteristics of high need achievers:

   - High need achievers have a strong desire to assume personal responsibility for performing a task or finding a solution to a problem.
   - High need achievers tend to set moderately difficult goals and task calculated risks.
   - High need achievers have a strong desire for performance feedback.

   Individuals with a high need for achievement generally will take moderate risks, like situations in which they can take personal responsibility for finding solutions to problems and want concrete feedback on their performance. As McClelland points out, “No matter how high a person’s need to achieve may be, he cannot succeed if he has no opportunities, if the organization keeps him from taking initiative, or does not reward him if he does good. Thus, if management wishes to motivate individuals operating on the achievement level, it should assign them tasks that involve a moderate degree of risk of failure, delegate to them enough authority, to take initiative in completing their tasks, and give them periodic, specific feedback on their performance.

2. Need for Power (n Pow):- The need for power is concerned with making an impact on other, the desire to influence other, the ways to change people, and the desire to make a difference in life. People with a high need for power are people who like to be in control of people and events. This results in ultimate satisfaction to man.

   People who have a high need for power are characterized by:

   - A desire to influence and direct somebody else.
   - A desire to exercise and control over others.
   - A concern for maintaining leader-follower relations.

   The need for power is expressed as a desire to influence others. In relation to Maslow’s need hierarchy, power would fall somewhere between the needs for esteem and self-actualization. People with a need for power tend to exhibit behaviors such as out-spookiness, forcefulness, willingness to engage in confrontation and a tendency to stand by their original position. They often are persuasive speakers and demand a great deal from others. Management often attracts people with a need for power because of the many opportunities it offers to exercise and increase power. Managers who are motivated by the need for power are not necessarily "power hungry" in the sense in which the expression is often used.

3. Need for Affiliation (n Aff):- The need for affiliation is defined as a desire to establish and maintain friendly and warm relations with other people. The need for affiliation, in many ways, is similar to Maslow's need hierarchy. The people with high need for affiliation have these characteristics:

   - They have a strong desire for acceptance and approval from others.
   - They tend to confirm to the wishes of those people whose friendship and companionship they value.
   - They give value and feeling to others.

   In conclusion, McClelland's definitive motive is similar to Maslow's theory. The person is concerned with forming friendly relations with others, desire for companionship, and the desire to help others. People dominated by inflictive need would be attracted to jobs that allow considerable social interactions interpersonal relations. A manager could also facilitate their need satisfaction by spending more time with such individuals and periodically bringing them together as a group.

   Limitations of Achievement Theory

   - The theory does not deal fully with the process of motivation and how it really takes place.
   - Persons with high need for achievement expect similar results from others. As a result, they may lack human skills and patience for being effective managers.
   - The use of protective techniques for developing achievement motive is objectionable.
   - The research evidence in support of the achievement motivation theory is fragmentary and doubtful.

6. J. Stacy Adam's Equity Theory

Equity theory, most popularly known as equity theory of motivation, was first developed by John Stacey Adams, a workplace. Equity theory is simple and almost instinctual. Adams' Equity Theory calls for a fair balance to be struck between an employee's inputs (hard work, skill level, tolerance, enthusiasm, and so on) and an employee's outputs (salary, benefits, intangibles such as recognition, and so on).

The motivation equity theory calls for a balance between employee's inputs and outputs. If employees have a good grasp on what they are doing and what they want to achieve and how it will benefit them, they're more likely to stay motivated. It focuses on the premise that to be motivated, they're being rewarded fairly for the contribution from their side.

If the rewards don't match the efforts, employees feel distressed and demotivated. Result: Less motivation, fewer efforts, and bad results going forward.

The concept of equity and exchange relationships derived from it will help you understand this theory in a better way.

- Overpaid Inequity :- When an individual perceives that his outcomes are more as compared to his inputs, in relation to others. The overpaid inequity can be expressed as:

$$\frac{\text{Person's Outcome}}{\text{Person's Inputs}} > \frac{\text{Other's Outcome}}{\text{Other's Inputs}}$$

- Underpaid Inequity:- When an individual perceives that his outcomes are less as compared to his inputs, in relation to others. The Underpaid Equity can be expressed as:

$$\frac{\text{Person's Outcomes}}{\text{Person's Inputs}} < \frac{\text{Other's Outcomes}}{\text{Other's Inputs}}$$

- Equity:- An individual perceives that his outcomes in relation to his inputs are equal to those of others. The equity can be expressed as-

$$\frac{\text{Person's Outcomes}}{\text{Person's Inputs}} = \frac{\text{Other's Outcomes}}{\text{Other's Inputs}}$$

Thus, adams equity theory shows how motivation is derived from the working environment around us. If someone thinks they're treated fairly, they'll contribute more. If not, they won't perform well at all. It is where bias comes into the picture and if not addressed on time, it leads to good employees exiting the organization at the first opportunity they get.

There are two kinds of factors. Inputs and Outputs. It is helpful to consider and utilize them while working towards elevating employee experience to the next level at an organization. Let's have a detailed look at types of Input and Output factors for Adams' equity theory.

Inputs (Some common ones):

- Effort.
- Loyalty.
- Hard work.
- Commitment.
- Knowledge and experience.
- Skills.
- Ability.
- Adaptability.
- Flexibility.
- Acceptance of others.
- Determination.
- Enthusiasm.
- Trust in superiors.
- Support of colleagues.
- Personal sacrifice.

Outputs (Some common ones):

- Recognition.
- Financial rewards (such as salary, benefits, perks).
- Reputation.
- Responsibility.

- Sense of achievement.
- Praise.
- Stimulus.
- Sense of advancement/growth.
- Job security.

Not all inputs or outputs can be quantified and measured easily. However, the theory suggests that managers should help employees manage given input and expected output. Better balance leads to an increase in employee satisfaction. It's best to create a sense of fairness within a team to ensure maximum levels of motivation, engagement, and performance.

Adams equity theory of motivation has become popular among organizations as it helps HRs think and set better decision-making processes at the core. An individual is said to be highly motivated if he perceives to be treated fairly. While the feelings of de-motivation arise, if an individual perceives to be treated unfairly in the organization. The fact that removal of bias and fairness are important for motivation and employee wellbeing, has helped organizations prioritize their relationships with the employees. The ones who have adopted this theory have seen better engagement, higher retention rate, and overall a productive workforce. This is why motivation equity theory is great to implement in modern times.

7. Victor Vroom's Expectancy Theory:-

The expectancy theory was proposed by Victor Vroom of Yale School of Management in 1964. Vroom stresses and focuses on outcomes, and not on needs unlike Maslow and Herzberg. The theory states that the intensity of a tendency to perform in a particular manner is dependent on the intensity of an expectation that the performance will be followed by a definite outcome and on the appeal of the outcome to the individual.

The Expectancy theory states that employee's motivation is an outcome of how much an individual wants a reward (Valence), the assessment that the likelihood that the effort will lead to expected performance (Expectancy) and the belief that the performance will lead to reward (Instrumentality).

- Valence is the significance associated by an individual about the expected outcome. It is an expected and not the actual satisfaction that an employee expects to receive after achieving the goals.

  Valence: V(R) outcome → reward

- Expectancy is the faith that better efforts will result in better performance. Expectancy is influenced by factors such as possession of appropriate skills for performing the job, availability of right resources, availability of crucial information and getting the required support for completing the job.

  Expectancy: effort → performance (E→P)

- Instrumentality is the faith that if you perform well, then a valid outcome will be there. Instrumentality is affected by factors such as believe in the people who decide who receives what outcome, the simplicity of the process deciding who gets what outcome, and clarity of relationship between performance and outcomes.

  Instrumentality: performance → outcome (P→O)

Thus, the expectancy theory concentrates on the following three relationships:

- Effort-performance relationship: What is the likelihood that the individual's effort be recognized in his performance appraisal?
- Performance-reward relationship: It talks about the extent to which the employee believes that getting a good

performance appraisal leads to organizational rewards.

- Rewards-personal goals relationship: It is all about the attractiveness or appeal of the potential reward to the individual.

Vroom was of view that employees consciously decide whether to perform or not at the job. This decision solely depended on the employee's motivation level which in turn depends on three factors of expectancy, valence and instrumentality.

Expectancy theory of motivation in terms of a mathematical formula:

$$\text{Motivation} = \text{Valence} \times \text{Expectancy} \times \text{Instrumentality.}$$

Advantages of the Expectancy Theory

- It is based on self-interest individual who want to achieve maximum satisfaction and who wants to minimize dissatisfaction.
- This theory stresses upon the expectations and perception; what is real and actual is immaterial.
- It emphasizes on rewards or pay-offs.
- It focuses on psychological extravagance where final objective of individual is to attain maximum pleasure and least pain.

Limitations of the Expectancy Theory

- The expectancy theory seems to be idealistic because quite a few individuals perceive high degree correlation between performance and rewards.
- The application of this theory is limited as reward is not directly correlated with performance in many organizations. It is related to other parameters also such as position, effort, responsibility, education, etc.

Implications of the Expectancy Theory

- The managers can correlate the preferred outcomes to the aimed performance levels.
- The managers must ensure that the employees can achieve the aimed performance levels.
- The deserving employees must be rewarded for their exceptional performance.
- The reward system must be fair and just in an organization.
- Organizations must design interesting, dynamic and challenging jobs.
- The employee's motivation level should be continually assessed through various techniques such as questionnaire, personal interviews, etc.

Decision-Making – Types and Process

5.7

5.7.1 Decision Making

Every organization needs to take decisions at one point or other as part of managerial process. Decisions are made in the best interest of the organization. For that matter, decisions made by the organization are to lighten the way forward. Be it strategic, or any business activities, processes of making decisions is complex, involves professionals of different genre. While small organization involves all levels of managers, complex organizations largely depend on a team of professionals specially trained to make all sorts of decisions. Decisions are taken to support organizational growth. The whole fabric of management, i.e. its day to day operation is rightly built on managerial decisions.

A manager has to decide the long-term objectives of the organisation, strategies, policies and procedures to be adopted to achieve these objectives; he has to decide how the jobs should be structured to match the jobs with the individuals in the organisation; he has to decide how to motivate the people to achieve higher performance; he has to decide what activities should be controlled and how to control these activities etc. in other words, decision- making is the substance of a manager's job. So, one of the indispensable components of management of organisations is the decision making.

Herbert a. Simon equated management with decision making because whatever a manager does is nothing but decision-making. All the functions of management involve decision-making and hence it is all-pervasive in nature.

Definition of Decision Making

- According to Felix M. Lopez "a decision represents a judgement: a final resolution of a conflict of needs, means, or goals; and a commitment to action made in the face of uncertainty, complexity and even irrationality". Thus, a decision is a course of action which is consciously chosen for achieving a desired result.
- In the words of George R. Terry, "decision-making is the electing of an alternative from two or more alternatives, to determine an opinion or a course of action".
- A more comprehensive definition of decision-making is given by Andrew Szliagyl in terms of the following: "decision-making is a process involving information, choice of alternative actions, implementation, and evaluation that is directed to the achievement of certain stated goals".
- John Mcdonald stressing the importance of decision making opines "the business executive by profession is a decision maker. Uncertainty is his opponent, and overcoming it is his mission. Whether the outcome is a consequence of luck or wisdom, moment of revision is without doubt the creative event in the life of the executive."

Thus, a decision is the selection of a course of action from several alternatives and the decision- making is the process of arriving at the final selection.

Characteristics of Decision Making

On the basis of above definitions the main characteristics of decision making are as follows.

(i) Decision making is a process of making a rational choice or selecting one of the various alternative courses of action.

(ii) Decision making is necessary only when different alternative solutions are available.

(iii) Decision making is a purposeful activity.

(iv) Decision making involves the commitment of resources and reputation of the organization.

(v) Decision making is always related to the situation or environment.

5.7.2. Types of Decision Making

There are several types of decisions:

- Routine and Strategic Decisions: Tactical or routine decisions are made repetitively following certain established rules, procedures and policies. They neither, require collection of new data nor conferring with people. Thus they can be taken without much deliberation. They may be complicated but are always one dimensional. They do not require any special effort by the manager. Such decisions are generally taken by the managers at the middle and lower management level. Strategic or basic decisions, on the other hand, are more important and so they are taken generally by the top management and middle management. The higher the level of a manager, the more strategic decisions he is required to take. The strategic decisions relate to policy matters and so require a thorough fact finding and analysis of the possible alternatives. Finding the correct problem in such decisions assumes great importance. The managers are more serious about such decisions as they influence the decision making at the lower levels.

- Programmed and Non-programmed Decisions: The programmed decisions are of routine and repetitive natures which are to be dealt with according to specific procedure. But the non-programmed decisions arise because of unstructured problems. There is no standard procedure for handling such problems. For example, if an employee absents himself from his work for a long time without any intimation the supervisor need not refer this matter to the chief executive. He can deal with such an employee according to the standard procedure which may include charge sheet, suspension, etc. But if a large number of employees absent themselves from work without any information such a problem cannot be dealt in routine manner. It has to be dealt with as an unstructured problem and the decision should be taken by the chief executive. Non-programmed decisions require thorough study of the problem and scientific analysis of the situational factors. There has to be adequate probing analysis of various alternatives before taking such decisions.

- Policy and Operating Decisions: Policy decisions are of vital importance and are taken by the top management. They affect the entire enterprise. But operating decisions are taken by the lower management in order to put into action the policy decisions. For example, a bonus issue is a policy matter which is decided by the top management, but the calculations of bonus is an operating decision which is taken at the lower levels to execute the policy decisions.

- Organisational and Personal Decisions: Organisational decisions are those which a manager takes in his official capacity. Such decisions can be delegated. But, personal decisions, which relate to the manager as an individual and not as a member of the organization, cannot be delegated.

- Individual and Group Decisions: When a decision is taken by an individual in the organisation, it is known as individual decision. Such decisions are generally taken in small organisations and in those organisations where autocratic style of management prevails. Groups or collective decisions refer to the decisions which are taken by a group of organisational members, say Board of Directors or committee.

5.7.3 Decision Making Process

Decision making is every manager's primary responsibility. To make good decisions, managers should invariably follow a sequential set of steps as presented below:-

(a) Identifying and diagnosing the real problems: The first step in the decision-making process is the identification of the problem. Diagnosing the problem implies knowing the gap between what we want to happen and what is likely to occur if no action is taken. As pointed out by Newman and summer, identifying the 'cause of the gap' and understanding the problem solve the problem. According to Peter F. Drucker, critical factor analysis is helpful in identifying the causes of the problem properly. A decision maker should collect as much information as possible before attempting to solve it. If possible, in addition to Tacts, opinion should also be collected, which would aid in diagnosing the problem effectively.

(b) Developing alternatives: While selecting the alternative course of action a manager should consider the viable and realistic alternatives only. Further, he should consider the time and cost constraints and psychological barriers that would restrict the number of reasonable alternatives. Newport and Trewatha contend that the brain storing and group participants may be fruitfully employed in developing alternatives. Ingenuity, research and creative imagination are required to ensure that the best alternatives are considered before a course of action is selected for inclusion of it among the alternatives.

(c) Evaluation of alternatives: Perhaps one of the most important steps in decision making is the evaluation of each alternative. Here, the decision-maker draws balance sheet of every alternative by identifying the advantages as well as disadvantages of these alternatives. All pertinent facts about each alternative should be collected, the pros and cons must be considered and the important points must be distinguished from the trivial or peripheral matters. The purpose of all this exercise is to limit the number of alternatives to a manageable size and then consider the alternatives for the selection.

    Some of the criteria for evaluating an alternative could be —

    (i) resources available for implementing the alternative

    (ii) economy of effort

    (iii) element of risk involved

    (iv) results expected

    (v) time constraint

    (vi) accomplishment of common goal

    (vii) implementation problems etc.

(d) Selection of an alternative: the next important step in decision-making process is the selection of best alternative from various available alternatives. Indeed, the ability, to select the best course of action from several possible alternatives separates the successful managers from the less successful ones. Drucker mentions four criteria viz. the risk, economy of effort timing, and limitation of resources, before one alternative is selected among the available ones.

(e) Implementation and follow up of the decision: The final step in decision making process is the implementation of the selected alternative in the organisation. The alternative-selected should be properly communicated to those members of organisation who are concerned with the decision. acceptance of the decision by group-members is absolutely essential to the successful implementation further, after implementation of the decision it is necessary to follow up to see whether the decision is yielding the desired results or not. A manager should least hesitate to ride out a decision that does not accomplish its objective. A manager should see it necessary, that all organisational members participate in the decision making as decision implementation.

5.7.4 Techniques of Decision Making

Two types of decision making techniques are as follows: Quantitative Techniques of Decision Making

(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.

(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 minimise 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.

Modern Techniques for Non-programmed Decisions

(i) Creative Techniques: creative thinking is needed for solving novel, non-routine problems. Creativity refers to ability to generate new ideas and new ways of doing things. Brainstorming is one of the creative techniques. It involves use of the brain to find different ideas which can solve a critical problem. it is a group based technique. Members of the group in a session are encouraged to throw up all possible alternative solutions to a problem. The ideas may be wild or impractical but they may lead to a creative solution ultimately.

(ii) Participative Techniques: Employee participation in management and decision making is often hailed as industrial democracy. The participative approach has several positive attributes for problem solving purposes. Involvement of individuals and groups in decision-making improves the quality of decisions, fosters responsibility and commitment for implementing them, enhances employee motivation and morale, and results in more acceptable and timely decisions and so on.

(iii) Heuristic Techniques: It is a sophisticated type of trial and error technique to find solutions to complex problems on a step by step basis. it recognises the fact that decision making in complex, strategic problems cannot be too rational and systematic. it is bound to be sporadic and fragmented because of information gaps, conflict in goals, perverse human behaviour and the uncertain nature of the environment. Certain rules of thumb or heuristics are developed to facilitate the transition towards decisions. There are great possibilities for using computers to employ heuristics technique for solving major strategic problems.

Guidelines For Effective Decision Making

One of the measures of effective management is the extent to which managers adopt effective decision making processes to make decisions. a decision making process and a decision is effective if it makes significant contribution to the achievement of managerial and organisational objectives at acceptable levels of costs and unsought consequences. Within this broad setting, we may identify the principles, guidelines or the ways and means of making the process effective, as follows:

1. Establishment of multiple decentralised centres of managerial decision making at appropriate organisational levels and delegation of adequate authority along with pinpointing of accountability for making decisions to managers at each centre.
2. Determination of appropriate decision-making work-load at each centre, so as to minimise the possibility of overloading at any centre.
3. Co-ordination of various decisions making centres through communication and other means so as to ensure consistency and co-operation in making decisions
4. Establishment of expert advisory staff units to provide the needed intellectual and professional inputs for decision making.
5. Formulation and communication of organisational objectives, policies, decision rules and procedures to serve as guidelines to managers in their decision making function.
6. Design and installation of decision support systems which include information and control systems so as to provide logistic support to managers.

Exercise

Theoretical Questions

I. Multiple Choice Questions (MCQ)

1. Who considered co-ordination as a permeating function of management passing through the managerial functions of planning, organizing, staffing, leading and controlling?

   (a) George Terry and Theo Haimann

   (b) Henry Fayol

   (c) Haynes and Massie

   (d) Hicks and Gullet

2. Which is inherent in managerial job and embodied in all the functions of management?

   (a) Planning

   (b) Organising

   (c) Control

   (d) Co-ordination

3. According to Mary Parker Follett which one is not the principle for achieving effective coordination?

   (a) Continuity

   (b) Early beginning

   (c) Self-coordination

   (d) Managerial Audit

4. Who emphasized harmony of objectives is crucial to the success of direction?

   (a) F.W.Taylor

   (b) Henry Fayol

   (c) Peter Drucker

   (d) George Terry

5. A manager has to exhibit the style of leadership depending on the

   (a) Performance

   (b) Time

   (c) Situation

   (d) Period

6. Which of the following statements is not correct?

   (a) Management is a goal-oriented process

   (b) Management is a universal process

   (c) Management is a continuous process

   (d) Management is a rigid process

7. Which of the following is not a function of managers?

   (a) Designing

   (b) Organizing

   (c) Leading

   (d) Planning

8. Which of the following does not corroborate the concept of 'Management as a Science'?

   (a) Cause & Effect Relationship

   (b) Test of Validity

   (c) Personal Skill

   (d) Experimentation & Observation.

9. ___________ involves missions and objectives.

   (a) Organizing

   (b) Planning

   (c) Staffing

   (d) Coordination

10. Management is what a manger does____________.

    (a) Peter F. Drucker.

    (b) Terry.

    (c) Louis Allan.

    (d) Henry Fayol.

11. Management is the art and science of decision making and leadership.

    (a) Harold Koontz.

    (b) Donald J. Clough.

    (c) Louis Allan.

    (d) Terry.

12. Agency theory suggests that managers(the agents), particularly those of large , publicly-owned firms, may have different objectives from those of the:

    (a) Workers,

    (b) Subordinates,

    (c) Shareholders,

    (d) Employees

13. The view that sees profit maximization as the main objective is known as:

    a) Shareholder theory

b) Agency Theory

c) Stakeholder theory

d) Stewardship theory

14. Which of the following is the best example of Agency Theory problem? Assuming the company is paying employees' travel expenses.

    (a) Mr. Sharma, the CFO of ABC Ltd, travels to China to have an official meeting with the financiers who are financing for setting up factory of ABC Ltd at Hunan province of China. While in China, he tours the Great Wall of China

    (b) Mr. Paul, the MD of XYZ Ltd, travels to New Delhi to attend an International Convention for New Business Opportunities in India. After the conference he had a stay at Agra to visit Tajmahal.

    (c) Ms. Banerjee , the controller, travels to London to visit the Lords Cricket Ground with friends. While there, she talks with her friends about employment opportunities at the firm.

    (d) Maria, Chief Marketing Officer, travels to New York to attend a sales convention. While there she visits Disneyland.

15. Which one of the following represents the best effort to reduce the agency problem?

    (a) paying senior managers a cash bonus each year based on the number of people employed by the company

    (b) giving senior managers bonuses consisting of shares of company share whenever the company improves its production efficiency

    (c) increasing the salary of the company president every time the company opens a new store

    (d) providing company cars to all managers employed by the firm for more than one year

16. Agency Theory' developed by-

    (a) Alchian and Demsetz

    (b) Jensen and Meckling

    (c) Jensen and Fama

    (d) All of the above

17. Who had said that leader's stewardship choice can motivate and facilitate reciprocal stewardship behavior from the employee?

    (a) Pearson and Marler

    (b) Alchian and Demsetz

    (c) Davis, Schoorman and Doanldson

    (d) Jensen and Meckling

18. According to Davis, Schoorman and Donaldson (1997), the managers being a steward of the company will try to protect and maximize -------------through firm performance.

    (a) shareholder's wealth

    (b) stakeholder's wealth

(c) both (a) and (b)

(d) none of the above

19. Which of the following regarding residual loss is correct?

(a) Bonding costs do not have an effect on residual loss.

(b) Residual loss is incurred by the agent because an agency relationship exists.

(c) A reduction in residual loss is likely to be the result of an increase in monitoring costs

(d) Under agency theory, residual loss can be reduced to zero by good governance.

20. Which of the following regarding agency theory is correct?

(a) Agency theory only applies to large entities.

(b) Agents are assumed to be in a position of power.

(c) Agents act in the best interest of the principal.

(d) Agency theory defines the relationship between agents and directors.

21. Which of the following is not an agency cost?

(a) Residual loss.

(b) Bonding costs.

(c) Concurrent loss

(d) Monitoring costs.

22. _____ is defined as the process of obtaining and maintaining the capable and competent people to fill all positions from top to operative level.

(a) Staffing

(b) Selection

(c) Recruitment

(d) Training

23. According to Koontz and O'Donnell staffing is the _____ function.

(a) Organisational

(b) Management

(c) Executive function

(d) None of the above

24. _____ 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

25. Selection is a process of rejection and hence it is called a _____ process
    (a) Positive
    (b) Negative
    (c) Either (a) or (b)
    (d) None of the above
26. T-group training is also known as
    (a) Classroom Training
    (b) Apprenticeship Training
    (c) Internship Training
    (d) Sensitivity Training
27. Training conducted away from the actual work setting is called
    (a) On-the-Job Training
    (b) Off-the-Job training
    (c) Step-by-Step Training
    (d) Job-Instruction Training
28. Which of the following are the methods of off-the-job training?
    (a) Role playing
    (b) Case studies
    (c) Lectures, classroom instruction
    (d) All of the above
29. External sources of recruitment include:
    (a) Employment Exchanges
    (b) Advertisements
    (c) Employee walk-ins
    (d) All of the above
30. _____ refers to the introduction of a person to the job and the organization.
    (a) Induction
    (b) Placement
    (c) Orientation
    (d) None of the above
31. The process of increasing the knowledge and skills of an employee for doing a particular job is known as
    (a) Training

(b) Development

(c) Education

(d) None of the above

32. The process which involves growth of an employee

(a) Training

(b) Development

(c) Education

(d) None of the above

33. _____ refers to assigning rank and responsibility

(a) Training

(b) Development

(c) Education

(d) Placement

34. Which activity brings the job-seeker and employer in contact with one another?

(a) Recruitment

(b) Selection

(c) Induction

(d) Placement

35. The process of choosing candidates who best meet the qualifications and requirements of the job is

(a) Recruitment

(b) Selection

(c) Induction

(d) Training

36. The process involves seeking and attracting a pool of people from which qualified candidates for Job Vacancies can be selected is

(a) Recruitment

(b) Selection

(c) Induction

(d) Placement

37. _____ is vital for determining personnel needs of the organization in future.

(a) Manpower Planning

(b) Recruitment

(c) Staffing

(d) None of the above

38. Which one is not the step in the staffing process?
    (a) Selection
    (b) Man power planning
    (c) Training and development
    (d) Education
39. The basic internal sources of recruitment are:
    (a) Transfers
    (b) Promotions
    (c) Dependents
    (d) All of the above
40. Who contends that "Training is an act of increasing the knowledge and skill of an employee for doing a particular job"?
    (a) Edwin Flippo
    (b) Michael J. Jucius
    (c) O. Jeff Harris
    (d) Andrew Carnegie
41. ______ skills 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
42. On-the-Job training is normally given by the
    (a) Superior (or) supervisor
    (b) Management
    (c) Organisation
    (d) None of the above
43. Which of the following methods are employed to make on-the-job training?
    (a) Coaching
    (b) Job rotation
    (c) Self-improvement programmes
    (d) All of the above
44. The assignment of a specific person to act as either an instructor or resource person for the trainee is
    (a) Coaching

(b) Apprenticeship training

(c) Vestibule training

(d) Job rotation

45. When an individual learns several different jobs within a work unit or department is known as

(a) Coaching

(b) Apprenticeship training

(c) Vestibule training

(d) Job rotation

46. Job rotation is recommended for _____ managers in almost all organizations.

(a) Lower Level

(b) Middle Level

(c) Top Level

(d) At all levels

47. Vestibule training is considered as a part of:

(a) Off-the-Job training

(b) On-the-Job Training

(c) Both (a) and (b)

(d) None of the above

48. Determination of the job to which an accepted candidate is to be assigned and his assignment to that job is

(a) Placement

(b) Orientation

(c) Induction

(d) None of the above

49. The first step in the organizing process is

(a) Division of work

(b) Grouping the work

(c) Identifying the work

(d) Establishing Formal reporting relationships

50. _____ enables managers to concentrate on important activities, avoiding the unnecessary duplications, overlapping and wastage of effort.

(a) Grouping the work

(b) Division of work

(c) Assignment of duties

(d) Identification and classification of work.

51. _____ is both an organizational necessity and a managerial responsibility.

(a) Planning

(b) Organising

(c) Control

(d) Co-ordination

52. _____ involves deciding in advance what is to be done, where, how and by whom it is to be done.

(a) Organising

(b) Decision making

(c) Planning

(d) None of the above

53. Which is the primary function of management?

(a) Planning

(b) Organising

(c) Directing

(d) Controlling

54. Who takes the initiative in formulating major objectives, strategies, policies and derivative plans?

(a) Middle management

(b) Top Management

(c) Lower management

(d) All of the above

55. Which of the following are called standing Plans?

(a) Policies

(b) Procedures

(c) Rules

(d) All of the above

56. Which of the following are called Single Use Plans?

(a) Programs

(b) Budgets

(c) Projects

(d) All of the above

57. The basic assumptions about the environment in which plans are expected to be implemented is known as

    (a) Decision making

    (b) Forecasting

    (c) Planning premises

    (d) None of the above

58. Planning premises can be categorized into:

    (a) Internal and External premises

    (b) Controllable, Semi Controllable and Uncontrollable premises

    (c) Tangible and Intangible Premises

    (d) All of the above

59. The premises which can be controlled by the management are known as

    (a) Internal premises

    (b) External premises

    (c) Controllable premises

    (d) Tangible premises

60. The premises on which management has some control is known as

    (a) Controllable premises

    (b) Semi-controllable premises

    (c) Uncontrollable premises

    (d) Intangible Premises

61. The premises over which a firm has no control are known as

    (a) Controllable premises

    (b) Semi-Controllable premises

    (c) Uncontrollable premises

    (d) None of the above

62. In which approach, top management takes the initiative in formulating major objectives, strategies, policies and derivative plans.

    (a) Top down approach

    (b) Bottom up approach

    (c) Composite approach

    (d) Team approach

63. In which approach, the task of planning is entrusted to a select team of managers.

    (a) Top down approach

    (b) Bottom up approach

    (c) Composite approach

    (d) Team approach

64. Which is a blend of top-down and bottom up approach in planning?

    (a) Top down approach

    (b) Bottom up approach

    (c) Composite approach

    (d) Team approach

65. Planning function is pervasive in the sense it is performed by managers at

    (a) All levels

    (b) Lower level

    (c) Middle level

    (d) Top Level

66. Planning is a:

    (a) Primary function

    (b) Secondary function

    (c) Supplementary function

    (d) None of the above

67. Strategic planning is done at ______________.

    (a) high levels of management.

    (b) lower level of management.

    (c) subordinates.

    (d) workers.

68. Operational planning is ___________.

    (a) long term planning.

    (b) medium term planning.

    (c) short term planning.

    (d) annual planning

69. Which of the following is not a part of staffing?

    (a) Publicity

    (b) Recruitment

(c) Selection

(d) Training

70. Which of the following is not an external source of recruitment?

(a) advertisement

(b) casual callers

(c) promotions

(d) recommendations of employees

71. The process of selection, training, promotion etc. of employees is stated as

(a) Organising

(b) Planning

(c) Directing

(d) Staffing

72. _____ is the process whereby an executive develops an orderly pattern of group effort among his subordinates and secures unity of action.

(a) Control

(b) Co-ordination

(c) Reporting

(d) Organising

73. The process of co-ordination must begin in the early stages of

(a) Control

(b) Planning

(c) Organising

(d) Staffing

74. Co-ordination must be carried on through the entire process of management from _____ to _____

(a) Planning to control

(b) Organising to Control

(c) Planning to Leadership

(d) None of the above

75. _____ has emphasized the principle of self-coordination.

(a) Henry Fayol

(b) George Terry

(c) Brown

(d) Peter Drucker

76. According to Brown, Self co-ordination means:

    (a) a particular department affects other departments and is in turn affected by them.

    (b) a particular department affects every department and is in turn affected by them.

    (c) every department affects a particular department.

    (d) none of the above

77. The heart of co-ordination is the _____ of purpose which involves fixing the time and manner of performing various activities.

    (a) Unity

    (b) Integrity

    (c) Achievement

    (d) None of the above

78. The term communication is derived from the Latin word

    (a) Common

    (b) Communis

    (c) Communication

    (d) None

79. _____ is the artery of an organization through which the decisions and instructions of the management flow down to the lowest levels.

    (a) Communication

    (b) Information

    (c) Message

    (d) None of the above

80. "Communication is an exchange of facts, ideas, opinions or emotions by two or more persons" according to:

    (a) A. Simon

    (b) Dalton Mc Farland

    (c) Newman and Summer

    (d) Louis A. Allen

81. Communication is the "process whereby decisional premises are transmitted from one member of an organization to another" – according to

    (a) A. Simon

    (b) Dalton Mc Farland

    (c) Newman and Summer

    (d) Louis A. Allen

82. _____ is a bridge of meaning between two or more people.
    (a) Communication
    (b) Information
    (c) Planning
    (d) Reporting
83. The process of communication starts with
    (a) Supervisor
    (b) Sender
    (c) Receiver
    (d) None of the above
84. _____ involves the selection of language in which the message is to be given.
    (a) Medium
    (b) Decoding
    (c) Encoding
    (d) Feed back
85. A thirsty person may use body language by lifting the thumb to face in order to communicate that he needs a glass of drinking water. This process is called:
    (a) Medium
    (b) Encoding
    (c) Decoding
    (d) Feedback
86. Which is said to be the carrier of message sent by a person to another?
    (a) Medium
    (b) Encoding
    (c) Decoding
    (d) Feedback
87. _____ involves interpretation of the message by the receiver, who will give meaning to the words, body language etc.
    (a) Medium
    (b) Encoding
    (c) Decoding
    (d) Feedback
88. Effective communication is always
    (a) Receiver oriented

(b) Sender oriented

(c) Message oriented

(d) None of the above

89. _____ is an essential to see that no distortion between the intended message and received message exists.

(a) Medium

(b) Encoding

(c) Decoding

(d) Feedback

90. Feedback may be

(a) Direct

(b) Indirect

(c) Either (a) or (b)

(d) Both (a) and (b)

91. Which communication is the official message that is communicated by a manager by virtue of his position in the organization structure?

(a) Formal communication

(b) Informal communication

(c) Grapevine communication

(d) Written communication

92. Formal communication is always

(a) Written

(b) Oral

(c) Both (a) and (b)

(d) None of the above

93. Informal means of circulating the information is also called as

(a) Grapevine

(b) Verbal

(c) Horizontal

(d) Written

94. When communication flows from top to bottom it is called _____

(a) Horizontal communication

(b) Upward communication

(c) Downward communication

(d) None of the above

95. When communication flows from bottom to up it is called _____

(a) Horizontal communication

(b) Upward communication

(c) Downward communication

(d) None of the above

96. When counication flows between various departments or people on the same level in an organization, it is called _____

(a) Horizontal communication

(b) Upward communication

(c) Downward communication

(d) None of the above

97. Horizontal communication is also known as

(a) Verbal communication

(b) Lateral communication

(c) Written communication

(d) None of the above

98. _____ communication helps an organization to coordinate the activities of various departments by sharing relevant information.

(a) Downward communication

(b) Upward communication

(c) Lateral communication

(d) All of the above

99. Which communication usually passes through written orders, reports and manuals?

(a) Downward communication

(b) Upward communication

(c) Lateral communication

(d) All of the above

100. Which communication creates a record of evidence?

(a) Verbal

(b) Written

(c) Formal

(d) All of the above

101. The message to be transmitted through verbal medium may be
   (a) Orders
   (b) Instructions
   (c) Reports
   (d) All of the above
102. Oral communication include
   (a) Face-to-face talks
   (b) Formal group discussions
   (c) Grapevine
   (d) All of the above
103. Formal communication is generally expressed in
   (a) Writing in manuals
   (b) Bulletins
   (c) Annual reports and hand books
   (d) All of these
104. Filtering means
   (a) Hiding some meaning
   (b) Disclose the information
   (c) Sending the message
   (d) None of the above
105. Which one is not the barrier to communication?
   (a) Filtering
   (b) Emotions
   (c) Message
   (d) Language
106. Tendency of people to interpret the same message in different ways may act as a _____ barrier.
   (a) Semantic
   (b) Emotions
   (c) Time pressure
   (d) Selective perception
107. Which of the following are barriers to communication?
   (a) Information overload

(b) Non-verbal cues

(c) Time pressures

(d) All of these

108. The task of ensuring that activities are producing the preset targets or goals is known as

(a) Directing

(b) Control

(c) Co-ordination

(d) None

109. "Control is any process that guides activity toward some predetermined goal" – by

(a) Anthony

(b) O' Doneel

(c) Haynes and Massie

(d) Hicks and Gullet

110. Control function is closely connected to

(a) Planning

(b) Organising

(c) Co-ordination

(d) All of the above

111. ______ without corresponding controls are apt to hollow hopes.

(a) Planning

(b) Organising

(c) Co-ordination

(d) Directing

112. 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

113. The first step in control process is

(a) Measurement of actual performance

(b) Establishment of standards

(c) Taking corrective action

(d) Comparing the actual performance with standards.

114. Standards (or) objectives (or) targets against which the actual performance is measured may be expressed in terms of:

(a) Physical standards

(b) Monetary standards

(c) Time standards

(d) Any of the above

115. If the actual result is far from the desired result corrective action is called for and it includes:

(a) Re-setting the standards

(b) Re-allocation of duties to employees

(c) Providing motivation to employees

(d) Any of the above

116. CPC means

(a) Critical path control

(b) Critical point control

(c) Critical point complaint

(d) Critical point complex.

117. The selected key areas for control are called

(a) Key result areas

(b) Key success factors

(c) Strategic points

(d) All of the above

118. ABC analysis is an example of

(a) Critical point control

(b) Control by exception

(c) Budgetary Control

(d) Break Even Analysis

119. Under ABC analysis, control attention is sought to be focused on ____ inventory items which are small in number but large in value.

(a) 'A' category

(b) 'B' category

(c) 'C' category

(d) All of the above

120. 'Control by exception' is also known as

(a) Management by objectives

(b) Management by exception

(c) Critical point control

(d) None of the above

121. According to 'Control by Exception', managers at each level should pay attention to only.

(a) Exceptional deviations

(b) Significant deviations

(c) Exceptional and significant deviations

(d) None of the above

122. Post control is also known as

(a) Feedback control

(b) Concurrent control

(c) Pre-control

(d) Feed Forward Control

123. Pre-control is also known as

(a) Feedback control

(b) Concurrent control

(c) Post-control

(d) Feed forward control

124. Which control is based on the notion that we can have control over events that will take place and not on events which have already taken place?

(a) Post control

(b) Concurrent control

(c) Pre-control

(d) Feed Forward control

125. Concurrent control is also known as

(a) Post control

(b) Pre-control

(c) Real-Time control

(d) Feed Forward control

126. Inventory control, production control, quality control etc. are administered as
    (a) Post control
    (b) Real time control
    (c) Pre-control
    (d) None of the above
127. Current control may also be regarded as
    (a) Steering control
    (b) Internal control
    (c) External control
    (d) None of the above
128. Preventive control is also known as
    (a) Post control
    (b) Pre-control
    (c) Concurrent control
    (d) Steering control
129. The term 'Cybernetics' was coined by
    (a) Norbert Weiner
    (b) George Terry
    (c) Theo Haimann
    (d) None of the above
130. The Thermostat in a refrigerator operates on the principle of
    (a) Steering control
    (b) Preventive control
    (c) Cybernetic control
    (d) Real Time control
131. Engineering process controls, computerized controls and procedure/rule based operational controls are examples which apply principles of
    (a) Steering control
    (b) Preventive control
    (c) Real-time control
    (d) Cybernetic control
132. Which of the following are techniques of control?
    (a) Budgetary control

(b) Management Information system

(c) Management Audit

(d) All of the above

133. Break-even analysis is also called as

(a) Cost volume profit analysis

(b) Ratio Analysis

(c) Financial Analysis

(d) None of the above

134. Break even analysis is adopted as a tool of

(a) Profit planning

(b) Cost planning

(c) Sales planning

(d) None of the above

135. Break even analysis is a technique of both

(a) Planning and co-ordination

(b) Control and decision making

(c) Planning and control

(d) Planning and budgeting

136. A systematic evaluation of the functioning, performance and effectiveness of management of organization is known as:

(a) Management Information System

(b) Management Audit

(c) Internal Audit

(d) None of the above

137. ____ and ____ are created in organization based on the principle of similarity and relatedness of the activities performed.

(a) Departments, Divisions

(b) Centralisation, Decentralisation

(c) Power and Authority

(d) None of the above

138. _____ is the right to act and extract obedience from others.

(a) Power

(b) Authority

(c) Responsibility

(d) None of the above

139. The process of assigning work to others and giving them authority to do is

(a) Control

(b) Organising

(c) Power

(d) Delegation of Authority

140. Delegation takes place between

(a) Superior and Subordinate

(b) Superior and Superior at same levels

(c) Subordinates and peers

(d) All of the above

141. Delegation may be

(a) Specific or general

(b) Written or implied

(c) Formal or Informal

(d) All of the above

142. 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

143. Delegation helps to improve the job satisfaction, motivation and morale of _____

(a) Subordinates

(b) Superiors

(c) Peers

(d) None of the above

144. _____ increases interaction and understanding among managers and subordinates.

(a) Centralisation

(b) Decentralisation

(c) Co-ordination

(d) Delegation

145. Delegation enables a manager to obtain the specialized knowledge and expertise of ____

(a) Superior

(b) Subordinates

(c) Peers

(d) None of the above

146. The process of delegation involves the following steps.

(a) Determination of results expected.

(b) Assignment of duties

(c) Granting of Authority

(d) All of the above

147. Managers are reluctant to delegate authority due to the following reasons.

(a) Lack of confidence in his subordinates

(b) Afraid of losing his importance.

(c) When they like to dominate the whole show.

(d) All of the above

148. Authority should _____ with responsibility.

(a) Commensurate

(b) Parity

(c) More than

(d) None of the above

149. There should be ____ between Authority and Responsibility

(a) Parity

(b) Commensurate

(c) Both (a) and (b)

(d) None of the above

150. _____ cannot be delegated.

(a) Authority

(b) Power

(c) Responsibility

(d) Accountability

151. Authority and ____ should be co-extensive.

(a) Power

(b) Responsibility

(c) Accountability

(d) Command

152. Centralisation and decentralization are _____ terms.

(a) Equal

(b) Different

(c) Opposite

(d) None of the above

153. Concentration of authority at the top level of the organization is known as ____

(a) Centralisation

(b) Decentralisation

(c) Delegation of Authority

(d) Responsibility

154. _____ means dispersal of authority throughout the organization.

(a) Centralisation

(b) Delegation of Authority

(c) Decentralisation

(d) None of the above

155. _____ is wide delegation of Authority.

(a) Centralisation

(b) Decentralisation

(c) Span of control

(d) Scalar Chain

156. Transfer of authority from one individual to another.

(a) Delegation

(b) Centralisation

(c) Decentralisation

(d) Communication

157. ____ implies diffusion of authority throughout the organization.

(a) Delegation

(b) Centralisation

(c) Decentralisation

(d) None of the above

158. Decentralisation is completed only when the fullest possible delegation is made at ___ of organization.
   (a) Lower levels
   (b) Top level
   (c) Middle level
   (d) At all levels
159. In delegation control rests entirely with
   (a) Subordinate
   (b) Superior
   (c) Top Level
   (d) Middle Level
160. ____ is a technique of management.
   (a) Delegation
   (b) Decentralisation
   (c) Centralisation
   (d) All of the above
161. ____ is a philosophy of management.
   (a) Delegation
   (b) Decentralisation
   (c) Centralisation
   (d) All of the above
162. Decentralisation helps in reduction of the work load of ____ executives.
   (a) Middle level
   (b) Lower level
   (c) Top level
   (d) None of the above
163. Quick decision making is possible in the case of
   (a) Centralisation
   (b) Decentralisation
   (c) Delegation
   (d) Both (b) and (c)
164. Decentralisation suffers from the following limitation.
   (a) Relief to top executive
   (b) Expensive

(c) Quick decision

(d) Executive development

165. ____ helps to avoid overlapping effort and duplication of work.

(a) Co-ordination

(b) Centralisation

(c) Decentralisation

(d) Delegation of Authority

166. Span of Management is also known as

(a) Span of Control

(b) Span of Supervision

(c) Span of authority

(d) All of the above

167. _____ represents the numerical limit of subordinates to be supervised and controlled by a single supervisor.

(a) Unity of Command

(b) Unity of Objective

(c) Span of Control

(d) Scalar Chain

168. Span of Control is based on the theory of relationships propounded by ___

(a) Graicunas

(b) George Terry

(c) Barnard

(d) Simon

169. The concept of Span of Management is central to the ____ theory.

(a) Neo-classical organization

(b) Classical organization

(c) Systems theory

(d) Contingency theory

170. Proper Span of Management is considered a necessity for effective.

(a) Supervision

(b) Control

(c) Co-ordination

(d) All of the above

171. There will be more organizational levels which in turn may impede communication, if the span of control is
    - (a) wide
    - (b) narrow
    - (c) Optimum
    - (d) None of the above
172. The supervisory load may become too heavy if the Span of Control is
    - (a) Wide
    - (b) narrow
    - (c) Optimum
    - (d) None of the above
173. Responsibility can be assigned to
    - (a) Human beings
    - (b) Non-living objects
    - (c) Both (a) and (b)
    - (d) None of the above
174. ____ is absolute and cannot be delegated.
    - (a) Authority
    - (b) Accountability
    - (c) Responsibility
    - (d) None of the above
175. Responsibility may be defined in terms of
    - (a) Functions
    - (b) Targets
    - (c) Goals
    - (d) All of the above
176. Responsibility flows in ____
    - (a) Downward direction
    - (b) Upward direction
    - (c) All directions
    - (d) None of the above
177. Subordinate is always responsible to his ___
    - (a) Peers

(b) Foremen

(c) Management

(d) Superior

178. Authority is the character of ________________ in a formal organization by virtue of which it is accepted by a contributor to, or member of the organization as generating the action he contributes, that is, as governing or determining what he does or is not to do so far as the organization is concerned.

(a) Communication

(b) Coordination

(c) Control

(d) Connection

179. Which of the following is/are the main characteristic(s) of authority are as follows:

(a) The authority given to a position is legal and legitimate

(b) The authority given to a position is legal and legitimate

(c) Authority is a relationship between two individuals

(d) All of the above

180. Authority is the right to give orders and the power to exact obedience defined by_________.

(a) Barnard

(b) Fayol

(c) Strong

(d) Louise Allen

181. The authority flows from top to bottom through the structure of an organization is__________

(a) The acceptance of authority theory

(b) The formal authority theory

(c) The competence theory

(d) The organization theory

182. Which theory is also called traditional authority theory_____________.

(a) The acceptance of authority theory

(b) The formal authority theory

(c) The competence theory

(d) The organization theory

183. The type of authority is invested with the persons by virtue of the office held by them is______________.

(a) The acceptance of authority theory

(b) The formal authority theory

(c) The competence theory

(d) The organization theory

184. The process whereby a manger shares his work and authority with his subordinates is____________.

(a) Decentralization

(b) Responsibility

(c) Delegation

(d) Decision making

185. The subordinate is granted authority to perform all the functions in his department or division is__________.

(a) General delegation

(b) Formal delegation

(c) Specific delegation

(d) Informal delegation

186. When an individual or a group agrees to work under the direction of an informal leader is called___________.

(a) Formal delegation

(b) Informal delegation

(c) General delegation

(d) Specific delegation.

187. The delegation of authority on the basis of custom, conventions or usage is known as___________.

(a) Oral delegation

(b) Written delegation

(c) Downward delegation

(d) Sideward delegation

188. The right of a person to give instructions to his subordinates is known as_________.

(a) Responsibility

(b) Authority

(c) Accountability

(d) Line authority.

189. Elements of delegation_________.

(a) Responsibility, authority, accountability

(b) Authority, delegation, accountability

(c) Responsibility, decentralization, centralization

(d) Controlling, responsibility, authority

190. The process of assigning authority and responsibility to one's subordinates to manage a project is called ______.

(a) Centralization

(b) Supervision

(c) Delegation

(d) Specialization

191. In __________, supervisory directly controls the activities.

(a) Committee

(b) Team

(c) Group

(d) Board.

192. Subordinate do not accept delegation of authority because of _____________.

(a) Absence of superior

(b) Fear of exposure

(c) Criticism

(d) More confidence in subordinate

193. _____________is the task entrusted by the manager to his subordinates.

(a) Authority

(b) Responsibility

(c) Direction

(d) Integration

194. Responsibility flows _____________.

(a) Upward

(b) Downward

(c) Diagonal

(d) Horizontal

195. A responsibility chart is a nice way of summarizing the relationship between _________________.

(a) Two persons

(b) Tasks and actors

(c) Tasks and performers

(d) Both (B) & (C)

196. Accountability is the liability created for the use of __________________.
   - (a) Authority
   - (b) Responsibility
   - (c) Accountability
   - (d) All of the above
197. The art of influencing others to direct their will, abilities and efforts to the achievement of goals is
   - (a) Directing
   - (b) Motivation
   - (c) Leadership
   - (d) Staffing
198. "Leadership is the ability of a manager to induce subordinates to work with confidence and zeal"–
   - (a) Haimann
   - (b) Koontz and O'Donnell
   - (c) Davis
   - (d) Rensis Likert
199. There can be no Leadership without
   - (a) Managers
   - (b) Subordinates
   - (c) Followers
   - (d) Superiors
200. Leadership process is interplay of three elements:
   - (a) The Leader, the follower and the situation.
   - (b) The Leader, the followers and the subordinates.
   - (c) The Leader, the followers and the superiors.
   - (d) None of the above
201. Leadership is a part of _____
   - (a) Organisation
   - (b) Management
   - (c) Both (a) and (b)
   - (d) None of the above
202. Which one is not the quality of a successful leader?
   - (a) Vision and foresight
   - (b) Human relations

(c) Physical energy & Stamina

(d) None of the above

203. Autocratic Leadership is also known as

(a) Authoritarian Leadership

(b) Democratic Leadership

(c) Free-rein Leadership

(d) None of the above

204. The leader who exercises complete control over the subordinates is

(a) Authoritarian Leadership

(b) Democratic Leadership

(c) Free-rein Leadership

(d) None of the above

205. Which leadership style permits quick decision making?

(a) Democratic Style

(b) Laissez – Fair Leadership

(c) Authoritarian Leadership

(d) None of the above

206. Which style leads to frustration, low morale and conflict among subordinates?

(a) Democratic Leadership

(b) Authoritarian Leadership

(c) Laissez Fair Leadership

(d) None of the above

207. Democratic Leadership is also known as

(a) Authoritarian Leadership

(b) Free-rein Leadership

(c) Laissez Fair Leadership

(d) Participative Leadership

208. ____ Style may be appropriate when the subordinates are well trained, highly knowledgeable, self-motivated-

(a) Autocratic Style

(b) Free-rein Style

(c) Participative Style

(d) All of the above

209. Leadership Continuum was developed by
    (a) Prof. Bernard
    (b) Prof. Terry
    (c) Tannenbaum and Schmidt
    (d) Stephen Robbins

210. Free-rein Leadership is also known as
    (a) Laissez Fair Leadership
    (b) Participative Leadership
    (c) Authoritarian Leadership
    (d) None of the above

211. Who avoids power and relinquishes the leadership position?
    (a) Autocratic Leader
    (b) Democratic Leader
    (c) Free Rein Leader
    (d) All of the above

212. Under which Leadership subordinates do not get the guidance and support of the Leader?
    (a) Free-rein Leadership
    (b) Autocratic Leadership
    (c) Participative Leadership
    (d) None of the above

213. Labour absenteeism and Labour turnover are reduced in case of
    (a) Autocratic Leadership
    (b) Democratic Leadership
    (c) Free-rein Leadership
    (d) None of the above

214. _____ Leadership Style may be appropriate when subordinates are uneducated, unskilled and submissive.
    (a) Participative Leadership
    (b) Autocratic Leadership
    (c) Free-rein Leadership
    (d) None of the above

215. Rensis Likert and his associates of the University of Michigan, USA conducted an extensive survey on ____ Style.
    (a) Leadership

(b) Management

(c) Both (a) and (b)

(d) Neither (a) nor (b)

216. System 1 managers are

(a) Exploitative Autocratic

(b) Benevolent Autocratic

(c) Consultative Autocratic

(d) Democratic

217. System 2 managers are

(a) Exploitative Autocratic

(b) Benevolent Autocratic

(c) Consultative Autocratic

(d) Democratic Autocratic

218. System 1 Managers believe in

(a) Rewards

(b) Penalties to motivate the subordinates

(c) Threats and Punishment

(d) All of these

219. According to Likert, which system of management is ideal system?

(a) System 1

(b) System 2

(c) System 3

(d) System 4

220. Under which system managers set goals and issue orders after discussing them with the subordinates?

(a) Exploitative Autocratic

(b) Benevolent Autocratic

(c) Consultative

(d) Democratic

221. Carrot and Stick approach to motivation is adopted under which system?

(a) Exploitative Autocratic

(b) Benevolent Autocratic

(c) Consultative

(d) Democratic

222. In which system, managers exercise strict supervision and control over the subordinates.
   (a) Exploitative Autocratic
   (b) Benevolent Autocratic
   (c) Consultative
   (d) Democratic

223. The system that adopts a paternalistic approach towards the subordinates is
   (a) Exploitative Autocratic
   (b) Benevolent Autocratic
   (c) Consultative
   (d) Democratic

224. An integrated model of Leadership has been proposed by:
   (a) Prof. Bernard
   (b) George Terry
   (c) FEW Taylor
   (d) Henry Fayol

225. Who conducted an extensive survey of management style and patterns in large number of organizations?
   (a) Rensis Likert and his associates
   (b) George Terry
   (c) Prof. Bernard
   (d) F.W. Taylor

226. ____ developed a continuum of four system of management.
   (a) George Terry
   (b) Prof. Bernard
   (c) F.W. Taylor
   (d) Rensis Likert

227. The term 'Motivation' has been derived from the word.
   (a) Motivate
   (b) Motivated
   (c) Motive
   (d) None of the above

228. ___ means urge to do something.
   (a) Power
   (b) Motive

(c) Authority

(d) None of the above

229. ____ is the reflection of needs and wants.

(a) Power

(b) Authority

(c) Motive

(d) None of the above

230. The process of inducing or inspiring people to take the desired course of action means

(a) Motivation

(b) Staffing

(c) Induction

(d) Training

231. The process of motivation begins with

(a) Fulfillment of Need

(b) Discovery of need

(c) Awareness of need

(d) Search for action.

232. ____ involves interaction between needs and incentives.

(a) Motivation

(b) Control

(c) Co-ordination

(d) None of the above

233. Motivation is a ____ concept.

(a) Psychological

(b) Mental

(c) Behavioural

(d) None of the above

234. Which of the following is not a financial incentive?

(a) Pay

(b) Allowance

(c) Recognition

(d) Bonus

235. Which of the following are non-financial incentives?
   - (a) Participation in decision making
   - (b) Challenging job
   - (c) Recognition
   - (d) All of the above

236. Is there any Universal Theory or approach to motivation?
   - (a) Yes
   - (b) False
   - (c) Partly True
   - (d) None of the above

237. High motivation provides
   - (a) Optimum utilization of resources.
   - (b) Better industrial relations.
   - (c) Reduction in Labour Turnover
   - (d) All of the above

238. Who developed a theory of motivation on the basis of hypotheses relating to human behavior?
   - (a) McGregor's
   - (b) J. Stacy Adam's
   - (c) Victor Vroom's
   - (d) Herzberg

239. The theory that implies use of 'Carrot and Stick' Approach is
   - (a) Theory Y
   - (b) Theory X
   - (c) Maslow's Need Hierarchy Theory
   - (d) Herzberg's Model

240. Abraham H. Maslow, an eminent American Psychologist, developed a General Theory of Motivation known as
   - (a) Theory X and Theory Y
   - (b) Need Hierarchy Theory
   - (c) Herzberg's Two Factory Theory
   - (d) J. Stacy Adam's Equity Theory

241. _____ needs are at the base of the Hierarchy according to Maslow.
   - (a) Safety needs

(b) Esteem needs

(c) Physiological needs

(d) Self-actualisation needs

242. Need Hierarchy Theory is also known as –

(a) General Theory of Motivation

(b) Victor Vroom's Expectancy Theory

(c) Theory X and Theory Y

(d) None of the above

243. Hierarchy of human needs –

(a) Physiological needs – Security needs – Social needs – Self Actualisation Needs – Esteem needs.

(b) Survival Needs – Safety Needs - Social needs – Esteem needs - Self Actualisation Needs.

(c) Physiological needs – Social needs – Safety needs – Esteem needs - Self Actualisation Needs.

(d) None of the above

244. Which needs are required to preserve the human life?

(a) Safety Needs

(b) Social Needs

(c) Physiological Needs

(d) Esteem Needs

245. Physiological needs are also known as

(a) Biological needs

(b) Survival needs

(c) Either (a) or (b)

(d) None of the above

246. Esteem Needs are classified into two types.

(a) Self esteem and esteem of others.

(b) Safety and security needs.

(c) Social needs and Esteem needs.

(d) None of the above

247. The example of Physiological need is

(a) Pension Scheme

(b) Competence

(c) Work Groups

(d) None of the above

248. The example of Esteem Need is
   (a) Reputation
   (b) Recognition
   (c) Achievement
   (d) All of the above
249. Which needs must be satisfied repeatedly?
   (a) Survival needs
   (b) Social needs
   (c) Safety needs
   (d) All of the above
250. Need for love and affection is ____
   (a) Survival needs
   (b) Social needs
   (c) Safety needs
   (d) All of the above
251. Which model is compatible with the economic theory of demands?
   (a) Theory X and Theory Y
   (b) Alderfer's ERG Theory
   (c) Herzberg Two Factor Theory
   (d) Maslow's Need Hierarchy Theory
252. Need recognition and fulfillment always follow the specific sequence of hierarchy suggested by Maslow:
   (a) True
   (b) False
   (c) Partly True
   (d) None of the above
253. The hierarchy of needs is not always fixed.
   (a) True
   (b) False
   (c) Partly True
   (d) None of the above
254. Maintenance factors are also known as
   (a) Hygiene Factors

(b) Motivating Factors

(c) Both (a) and (b)

(d) None of the above

255. Identify the maintenance factors from the below:

(a) Work itself

(b) Recognition

(c) Advancement

(d) Salary

256. Identify the motivating factors from the below

(a) Achievement

(b) Opportunity for growth

(c) Responsibility

(d) All of the above

257. Which factors are intrinsic parts of the Job?

(a) Motivational Factors

(b) Maintenance Factors

(c) Hygiene Factors

(d) None of the above

258. Maintenance Factors are called dissatisfiers.

(a) True

(b) False

(c) Partly True

(d) None of the above

259. Frederick Herzberg and his associates conducted interviews of ____ engineers and accountants in the Pittsburgh area of the United States.

(a) 600

(b) 200

(c) 20

(d) 2000

260. The distinction between maintenance factors and motivating factors is fixed.

(a) True

(b) False

(c) Partly True

(d) None of the above

261. Herzberg's Theory is an extension of ____

(a) Theory X and Theory Y

(b) Alderfer's ERG Theory

(c) Victor Vroom's Expectancy Theory

(d) Maslow's Need Hierarchy Theory

262. Maslow's Model is formulated in terms of

(a) Human needs

(b) Wants

(c) Rewards

(d) Goals

263. Herzberg's Model is formulated in terms of

(a) Human needs

(b) Wants

(c) Rewards or Goals

(d) None of the above

264. Herzberg suggested the use of ___ factors to avoid dissatisfaction.

(a) Motivating factors

(b) Environmental Factors

(c) Maintenance Factors

(d) None of the above

265. Reward Systems can be designed on _____

(a) Individual basis

(b) Group basis

(c) Either (a) or (b)

(d) None of the above

266. ______ reward systems can be in the form of piece work, production bonus and performance based commissions.

(a) Individual

(b) Group

(c) Either (a) or (b)

(d) None of the above

267. ____ reward systems are generally in the form of gain sharing and profit sharing.
   (a) Individual
   (b) Group
   (c) Either (a) or (b)
   (d) None of the above
268. Under a group reward system every member of a group is paid the same reward on the basis of ___
   (a) Individual performance
   (b) Group performance
   (c) Individual (or) Group performance
   (d) none of the above
269. Which of the following is not a maintenance factors?
   (a) Achievement
   (b) Responsibility
   (c) Advancement
   (d) All of the above
270. Which one is not the motivational theory?
   (a) Alderfer's ERG Theory
   (b) Contingency Theory
   (c) J.Stacy Adam's Equity Theory
   (d) Victor's Vroom's Expectancy Theory
271. Work is natural like rest or play according to
   (a) Theory Y
   (b) Theory X
   (c) Theory X and Theory Y
   (d) None of the above
272. Likert suggested that ____ is the ideal system towards which organizations should work.
   (a) System 1
   (b) System 2
   (c) System 3
   (d) System 4
273. Which of the following is not a leadership style?
   (a) Autocratic.
   (b) Democratic.

(c) Diplomatic.

(d) Free Rein.

274. Leadership behavior is influenced by certain qualities of a person is _____.

(a) Followers theory.

(b) Trait theory.

(c) Situational theory.

(d) Managerial grid.

275. The leadership theory study leaders behaviour is_____________.

(a) Followers theory.

(b) Trait theory.

(c) Behavioural theory.

(d) Managerial grid.

276. Followers decide whether a person is a leader or not is according to___________.

(a) Trait theory.

(b) Behavioral theory.

(c) Followers theory.

(d) System theory.

277. All decision-making power is centralized in the leader is under ________.

(a) autocratic style.

(b) liberal leader.

(c) democratic leader.

(d) institutional leader.

278. The leader makes decisions in consultation with his followers is___________.

(a) autocratic style.

(b) liberal leader.

(c) democratic leader.

(d) institutional leader.

279. A leader exercises his power over his followers because of his position held in the organizational hierarchy is_____________.

(a) autocratic leader.

(b) intellectual leader.

(c) liberal leader.

(d) institutional leader.

280. A leader motivates his followers to work hard by offering them rewards is____________.

(a) positive style.

(b) negative style

(c) autocratic style.

(d) democratic style.

281. Leader acts more as bosses then leadership style is______________.

(a) positive style.

(b) negative style.

(c) autocratic style.

(d) democratic style.

282. The authority is decentralized in which leadership style?

(a) positive style.

(b) negative style.

(c) free-rain style.

(d) democratic style.

283. The followers themselves take decisions for which they get authority under______________.

(a) positive style.

(b) negative style.

(c) free-rein style.

(d) democratic style.

284. The leader acts as a liaison officer between the employees and the outside world is______________.

(a) positive style.

(b) free-rein style.

(c) autocratic style.

(d) democratic style.

285. The contribution of a leader is nothing under_______________.

(a) positive style

(b) free-rein style

(c) autocratic style

(d) democratic style

286. In managerial grid, the style of management depicts the style of a leader who is neither concerned about the people nor does he care about the task to be performed is____________.

(a) task management.

(b) impoverished style.

(c) country club.

(d) team management style.

287. Motivation based on force of fear is called__________.

(a) negative motivation.

(b) positive motivation.

(c) extrinsic motivation.

(d) intrinsic motivation.

288. Motivation available at the time of performance of work is_________.

(a) negative motivation.

(b) positive motivation.

(c) extrinsic motivation.

(d) intrinsic motivation.

289. Wages, salaries, bonus, vacation pay, insurance are examples of ______.

(a) financial motivation.

(b) non-financial motivation.

(c) extrinsic motivation.

(d) intrinsic motivation.

290. Participation, recognition and power are some of the examples of__________.

(a) financial motivation.

(b) non-financial motivation.

(c) extrinsic motivation.

(d) intrinsic motivation.

291. Maslow's motivation theory is on the basis of human___________.

(a) satisfaction.

(b) needs.

(c) maintenance factors.

(d) rewards.

292. According to Maslow, physiological needs is a___________.

(a) high level needs.

(b) medium level needs.

(c) lower level needs.

(d) psychological needs.

293. According to Maslow, self-actualization needs is a __________.

    (a) high level needs.

    (b) medium level needs.

    (c) lower level needs.

    (d) psychological needs.

294. Self-confidence, independence, achievements, knowledge, status, recognition and appreciation examples of__________.

    (a) safety needs.

    (b) social needs.

    (c) ego needs.

    (d) self-actualization needs.

295. Herzberg's Hygiene factors___________.

    (a) motivate employees.

    (b) do not motivate employees.

    (c) dissatisfy employees.

    (d) satisfy employees.

296. Expectancy motivation theory is given by______________.

    (a) Vroom.

    (b) Maslow.

    (c) Herzberg.

    (d) Mc Gregor.

297. X and Y theory was introduced by_______.

    (a) Mc Gregor.

    (b) Peter Drucker.

    (c) Henry Fayol.

    (d) FW Taylor.

298. Esteem needs are also called as ________.

    (a) social needs.

    (b) self realization needs.

    (c) ego needs.

    (d) safety needs.

299. According to Herzberg's Motivation Hygiene Theory, which of the following is NOT a hygiene factor?

    (a) Working Conditions.

(b) Salary.

(c) Relationship with supervisor.

(d) Work itself.

300. Who equated management with decision making because whatever a manager does is nothing but decision making?

(a) Felix M. Lopez

(b) John Mc Donald

(c) Andrew Szliagyl

(d) Herbert A. Simon

301. A decision to launch a new production plant is

(a) Programmed decision

(b) Non-routine decision

(c) Personal decision

(d) Organisational decisions

302. Which decisions are repetitive and routine in nature?

(a) Basic decisions

(b) Personal decisions

(c) Programmed decisions

(d) Non-programmed decisions

303. _____ decisions are concerned with unique problems or solutions.

(a) Basic decisions

(b) Organisational decisions

(c) Programmed decisions

(d) Personal decisions

304. Decision to attend a wedding ceremony is

(a) Basic decisions

(b) Organisational decisions

(c) Programmed decisions

(d) Personal decisions

305. Programmed decisions are made by

(a) Lower level managers

(b) Top level managers

(c) Middle level managers

(d) None of the above

306 Non-programmed decisions are taken by

(a) Lower level managers

(b) Top level managers

(c) Middle level managers

(d) None of the above

307. Non-programmed decisions include

(a) decision to take over a sick unit

(b) to restructure the existing organization

(c) how to fill up the recently vacated position of zonal manager

(d) All of the above

308. ______ decisions are those that are repetitive and routine.

(a) Organisational decision

(b) Non-routine decisions

(c) Programmed decisions

(d) Non-programmed decisions

309. The first step in the decision making process is:

(a) Identification and diagnosing the real problem.

(b) Evaluation of alternatives

(c) Developing Alternatives

(d) Selection of an alternative

310. The sequential set of steps in decision making is

(a) Identification – Evaluation – Developing – Selection – Implementation.

(b) Identification – Developing – Evaluation – Implementation – Selection.

(c) Identification – Developing – Evaluation – Selection – Implementation.

(d) None of the above

311. The criteria for evaluating the alternative in decision making is:

(a) Resources available for implementing the alternative.

(b) Time constraint

(c) Accomplishment of common goal

(d) All of the above

312. Who suggested "Strategic factors refer to those that are most important in determining the action to be taken in solving a given problem".

(a) Chester I Barnard

(b) Louis Allen

(c) George Terry

(d) None of the above

313. What strategic factors should a manager has to consider while evaluating the alternatives?

(a) Tangible

(b) Intangible

(c) Both (a) and (b)

(d) Either (a) or (b)

314. Drucker mentions four criteria for selection of an alternative.

(a) Risk, economy of effort, timing and limitation of resources.

(b) Risk, economy of cost, timing and limitation of human resources.

(c) Value, economy of effort, timing and limitation of resources.

(d) Safety, value, timing and limitation of resources.

315. The final step in decision making process is:

(a) Selection of an Alternative

(b) Developing Alternative

(c) Evaluation of Alternative

(d) Implementation and follow up of decision.

316. Decisions into programmed decisions and non-programmed decisions is adopted by

(a) Peter Drucker

(b) Herbert Simon

(c) M. Lopez

(d) John Mc Donald

317. _____ decisions refer to decisions techniques and rules.

(a) Programmed decisions

(b) Non-programmed decisions

(c) Strategic decisions

(d) Tactical decisions

318. The decisions which are made on situations and problems which are novel and non-repetitive are:

(a) Programmed decisions

(b) Non-programmed decisions

(c) Strategic decisions

(d) Tactical decisions

319. Strategic decisions are made at which level

(a) Middle level

(b) Lower level

(c) Top level

(d) At all levels

320. Strategic decisions includes decisions on

(a) Plant location

(b) Introduction of new products

(c) Acquisition of outside enterprises

(d) All of the above

321. Tactical decisions are also known as

(a) Operational decisions

(b) Programmed decisions

(c) Non-programmed decisions

(d) Strategic decisions

322. Tactical decisions are made to implement

(a) Programmed decisions

(b) Non-programmed decisions

(c) Strategic decisions

(d) Individual decisions

323. Disadvantage of group decision making are:

(a) Delays in decision making

(b) Lack of rationality and responsibility among group members.

(c) Dilution of the quality of decisions.

(d) All of the above

324. Which of the following are quantitative techniques of decision making?

(a) Probability decision theory

(b) Queuing theory

(c) Simulation

(d) All of the above

325. Which of the following are the modern techniques for non-programmed decisions?

    (a) Creative techniques

    (b) Participative techniques

    (c) Heuristic techniques

    (d) All of the above

326. Which is a sophisticated type of trial and error technique to find solutions to complex problems on a step by step basis?

    (a) Creative techniques

    (b) Participative techniques

    (c) Heuristic techniques

    (d) None of the above

327. PERT and CPM are _____ techniques.

    (a) Queuing Theory

    (b) Simulation

    (c) Linear Programming

    (d) Network

328. The technique for observing the behavior of a system under several alternative conditions in an artificial setting is known as

    (a) Game theory

    (b) Simulation

    (c) Probability Decision Theory

    (d) Linear Programming

329. Brain Storming is one of the _____ techniques.

    (a) Creative

    (b) Participative

    (c) Heuristic

    (d) None of the above

330. The technique that involves use of the brain to find different ideas which can solve a critical problem is

    (a) Participative technique

    (b) Heuristic technique

    (c) Creative technique

    (d) All of the above

331. Decision making is the selection based on some criteria from two or more possible alternatives is defined by___________.

(a) Farland

(b) Mac Donald

(c) Terry

(d) M.C. Nites

332. The selection of best alternative from many alternatives is known as__________.

(a) Selection

(b) Decision-making

(c) Organizing

(d) Budgeting

333. According to _____________“decision-making is the electing of an alternative from two or more alternatives, to determine an opinion or a course of action”.

(a) Felix M. Lopez

(b) George R. Terry

(c) John McDonald

(d) Andrew Szliagyl

334. A ______ organizational structure is the simplest form and has clear lines of authority and ease of decision making.

(a) Horizontal

(b) Line

(c) Vertical

(d) Staff

335. The __________ relate to policy matters and so require a thorough fact finding and analysis of the possible alternatives.

(a) Strategic decisions

(b) Basic decisions

(c) Tactical or Routine decisions

(d) (A) or (B)

336. The decision taken by lower level management is a _____________.

(a) Programmed decision

(b) Non-programmed decision

(c) Major decision

(d) Minor decision

337. The decision taken by high level of management is _______________.
    (a) Programmed decision
    (b) Non-programmed decision
    (c) Individual decision
    (d) Non-economic decision
338. The first step in the decision making process is -
    (a) The analysis of the problem
    (b) Selecting the alternative course of action
    (c) The evaluation of each alternative
    (d) The identification of the problem
339. Linear programming is the technique for optimization of –
    (a) An objective function
    (b) A constraint function
    (c) A resource function
    (d) A probabilistic and not deterministic function
340. PERT represents which of the following term?
    (a) Project Execution Review Technique
    (b) Planning Execution Response Technique
    (c) Program Enhancement Report Technique
    (d) Program Evaluation Review Technique

II. True / False

1. Management applies to managers at all organizational levels.
2. Management is not a combination of an art, a science and a profession
3. Stewardship theory focusses on self-actualization needs
4. Agency theory orientation is collectivism
5. Agency theory focusses on basic level needs
6. According to Davis, Schoorman and Donaldson market was traditionally considered as one of the best place for judging management efficiency
7. Owner-manager conflict is referred to as a Type II agency problem
8. Planning enables people within an enterprise to work effectively and harmoniously for the accomplishment of the individual goals.
9. Planning is costly because it requires money, time and information.
10. Planning premises refer to the environment in which the plans are to be implemented.

11. Objectives, Policies, Procedures and rules are important Single Use Plans.
12. The premises that can be expressed in tangible physical terms are known as intangible premises.
13. The first step in the process of organizing is identifying the work.
14. Selection is probably the most critical step in the staffing process as it involves choosing candidates who best meet the qualifications requirements of the job.
15. Development is an act of increasing the knowledge and skill of an employee for doing a particular job in an organization.
16. Apprenticeship training is best example for Off the Job Training.
17. Communication is an exchange of facts, ideas, opinions or emotions by two or more persons.
18. Decoding is said to be the carrier of message sent by a person to another.
19. Emotions of both the sender and receiver influence the message that is transmitted and received
20. Monitoring helps organizations replicate the best projects/programs
21. A closed and hierarchical network is known as innovation mall
22. The authority given to a position is legal and legitimate.
23. Authority means ability to do something.
24. Authority can be visible from organizational chart.
25. Responsibility arises from a superior-subordinate relationship.
26. Responsibility is absolute and can be delegated.
27. Responsibility chart is an important technique that can supplement the use of Role Negotiation.
28. Accountability arises out of responsibility and the two go together.
29. Responsibility flows downward.
30. A superior is always responsible to his subordinate.
31. The art of influencing others to direct their will, abilities and efforts to the achievement of goals is called Leadership.
32. Autocratic Leadership is also known as Democratic Leadership.
33. The leader who exercises complete control over the subordinates is called Autocratic Leadership.
34. Leadership Continuum was developed by Tannenbaum and Schmidt.
35. Participative Leadership Style may be appropriate when subordinates are uneducated, unskilled and submissive.
36. Carrot and Stick approach to motivation is adopted under Benevolent Autocratic system.
37. Maintenance factors are also known as Hygiene factors.
38. The distinction between maintenance factors and motivating factors is fixed.
39. Likert suggested that System 4 is the ideal system towards which organizations should work.
40. Work is natural like rest or play according to Theory X.
41. Brain Storming is one of the participative techniques.
42. Tactical decisions are made repetitively following certain established rules, procedures and policies.

43. Programmed decisions are of routine and repetitive nature which is to be dealt with according to specific procedure.

44. Policy decisions are of vital importance and are taken by the Middle Management.

45. The final step in decision making process is selection of an alternative.

III. Fill in the blanks

1. A profession may be defined as an occupation backed by .... and ....
2. We can classify management into .... management, and .... management.
3. There is .... professional body to regulate the educational and training standards of the managers.
4. To be a successful manager, it is essential to acquire management skills through .... education and training.
5. Administrative management is primarily concerned with .... and ....
6. Operative management is concerned with the .... of the policies for the achievement of goals.
7. Owner-management relationship in stewardship theory is based on.................
8. Economic man model concept is followed in----------theory.
9. Owner-manager conflict is referred to as a ------- agency problem.
10. Stewardship Theory is developed by ....
11. Stewardship theory describes behavior rooted in a more ------------.
12. Last step in planning process is ________
13. ________ plans are the recurring plans and they are used repeatedly in situations of a similar nature.
14. ________ are basic assumptions about the environment in which plans are expected to be implemented.
15. The first step in the organizing process is ____________
16. The process of obtaining and maintaining the capable and competent people to fill all positions from top to operative level is called _________
17. Manpower planning is also called _________
18. _________ involves seeking and attracting a pool of people from which qualified candidates for job vacancies can be selected.
19. _________ refers to assigning rank and responsibility to an individual, identifying him with a particular job.
20. The internal sources of recruitment include the employees on the _________
21. The most crucial stage in staffing process is the _________
22. T – group training is also known as _________
23. In all physical and biological systems some message is transmitted in the form of mechanical transfer of energy, a chemical reaction, or any other means which is known as _________
24. Concurrent control is also known as _________
25. MIS means _________

26. Cost Volume Profit Analysis is also known as __________
27. Individual or group interest must be surrendered to ______ interest.
28. ________ is the chain of superior existing from the highest authority to the lowest ranks.
29. ________ to be replaced by rule of science to improve the standard of performance.
30. In case of Bureaucratic Management rules and regulations are ________
31. The term communication is derived from the Latin word _________
32. The process of communication starts with the _________
33. _________ involves the selection of language in which the message is to be given.
34. _________ involves interpretation of the message by the receiver.
35. _________ is aimed at monitoring the outcome of activities, reviewing feedback information about this outcome and if necessary take corrective action.
36. Control function is closely connected to _________
37. The first step in control process is _________
38. CPC means _________
39. Control by exception is also known as _________
40. Break even analysis is adopted as a tool of _________
41. Co-ordination is a continuous or _________ process.
42. The selected key areas for control are variously called _________
43. ABC analysis is an example of _________
44. _________ control involves evaluation of inputs.
45. The term power is often considered as synonymous to _________
46. ______ refers to the ability or capacity to influence the behavior or attitudes of other individuals.
47. The authority enjoyed by a position is not _________
48. _________ is a relationship between two individuals – one superior and the other subordinate.
49. Responsibility can be assigned to _______ only.
50. Responsibility flows ______
51. A ________ is a nice way of summarizing the relationship between tasks and actors.
52. _________ is an important technique that can supplement the use of responsibility charting.
53. _________ can be regarded as the right of power to delegate responsibility and it emanates in a company from the shareholders to the board of directors, and down the scalar chain.
54. Delegation of authority involves ________ some responsibility to subordinates.
55. ________ indicates minimum delegation.
56. ________ means extensive delegation.
57. In ________ organization, decentralization is suitable.
58. The term 'motivation' has been derived from the word ________.
59. Motive means the urge to do ________

60. Motivation is a ________ Concept.
61. Motivation is a ________ Process.
62. ERG stands for ________
63. ________ has developed a theory of motivation on the basis of hypotheses relating to human behavior.
64. Theory ________ is based on a faulty conception of human nature.
65. __________ an eminent American Psychologist developed a General Theory of Motivation.
66. Esteem needs are of two types : self-esteem and ________
67. Frederick Herzberg and his associates conducted interviews of ________ engineers and accountants in the Pittsburgh area of the United States.
68. ________ is needed for solving novel, non-routine problems.
69. ________ is a technique for observing the behavior of a system under several alternative conditions in an artificial setting.
70. The first step in decision making process is _____
71. Tactical decisions are also known as _______
72. Strategic decisions are also known as _______
73. Programmed decisions are of _____ in nature.
74. ________ decisions are those which a manager takes in his official capacity.
75. Group decisions are also called as ______
76. Matrices and Decision Trees are constructed to represent the _____
77. The final step in decision making process is ______
78. The main purpose of decision making is to ______ human behavior
79. ______decisions are routine in nature.

IV. Short Essay Type Questions

1. Explain the term 'management'.
2. What are the different levels of management?
3. Can management be considered as a profession?
4. "Management is neither a pure science nor a fine art". Comment.
5. Elucidate the concept of Stewardship Theory.
6. What is meant by Agency Costs? What are the various forms of agency costs? What are the possible remedies to the agency problems?
7. Compare and Contrast between Agency Theory and Stewardship Theory.
8. Explain Type I and Type II Agency problems with example.
9. Define Planning. Explain the Characteristics of Planning.
10. What are the limitations of Planning?
11. Explain the pre requisites of effective planning in an organization.

12. What are the steps in Planning Process?
13. Discuss the different approaches to planning.
14. Explain the different types of plans.
15. What is meant by planning premises? Into how many types the planning premises are categorized.
16. Define Organisation. Explain organization as a process.
16. What is meant by Staffing? Explain the importance of Staffing.
18. Explain the steps in the Staffing process.
19. What is meant by Recruitment? Explain the different sources of Recruitment.
20. Define Selection. Explain the process of selecting the candidates for employment in an organization.
21. Explain the merits and demerits of On the Job Training.
22. What are the merits and demerits of Off the Job Training?
23. Define Control. Explain the steps in Control Process.
24. What are the different types of Control used by Modern Organisations?
25. What are the prerequisites of an effective control system?
26. Explain the principles of control.
27. Explain the different techniques of Control
28. Define Communication. Explain the importance of Communication in an organization.
29. Explain the steps in Communication Process.
30. Explain the different types of Organisational Communication.
31. What are the different types of barriers to Communication?
32. How to overcome barriers in Communication?
33. Define Coordination. Explain the features of Coordination.
34. Explain the principles for achieving effective Coordination in an organization.
35. Define Authority and explain the characteristics of authority.
36. Define Responsibility and explain the characteristics of Responsibility.
37. What are the different techniques to define Responsibility in an organization?
38. Briefly compare between Authority, Responsibility and Accountability.
39. Define Delegation of Authority. Explain the characteristics of Delegation of Authority.
40. Explain the importance of Delegation of Authority.
41. Explain the steps in the process of Delegation of Authority.
42. What are the difficulties in the Delegation of Authority?
43. Explain the differences between Delegation and Decentralisation.
44. What are the advantages and disadvantages of decentralization?
45. What factors should be taken into consideration while deciding the degree of decentralization in an organization?
46. Write about Span of Management.

47. Explain line and staff authority
48. Briefly discuss the techniques of responsibility
49. What is meant by Motivation? Explain the characteristics of Motivation.
50. Explain the importance of Motivation.
51. Write about Mc Gregor theory of Motivation.
52. Briefly explain Maslow's Need Hierarchy Theory of Motivation.
53. Explain Herzberg's Two Factory of Motivation.
54. Define Leadership and explain the characteristics of Leadership.
55. Explain the qualities of a Successful Leader.
56. Explain the difference between Leadership and Management.
57. Explain the different types of Leadership Styles.
58. Write about Leadership Continuum.
59. Explain about the Likert's System of Management.
60. What are the measures to be taken for developing leadership ability of managers?
61. Explain the different types of Decisions.
62. Explain the Steps in decision making process.
63. What are the quantitative techniques of Decision Making?
64. Explain the Modern Techniques for Non-Programmed Decisions.
65. Briefly explain the guidelines for effective decision making.

Answer:

Theoretical Questions

I. Multiple Choice Questions (MCQs)

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
a	d	d	a	c	d	a	c	b	c	b	c	b	c	b	d	a	a	c	b
21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40
c	a	c	b	b	d	b	d	d	a	a	b	d	a	b	a	a	d	d	a
41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60
d	a	d	a	d	b	a	a	c	d	a	c	a	b	d	d	c	d	c	b
61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80
c	a	d	c	a	a	a	c	a	b	d	b	b	a	c	a	a	b	a	c
81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
a	a	b	c	b	a	c	a	d	c	a	a	a	c	b	a	b	c	a	b
101	102	103	104	105	106	107	108	109	110	111	112	113	114	115	116	117	118	119	120
d	d	d	a	c	a	d	b	c	a	a	a	b	d	d	b	d	a	a	b

121	122	123	124	125	126	127	128	129	130	131	132	133	134	135	136	137	138	139	140
c	a	d	a	c	b	a	b	a	c	d	d	a	a	c	b	a	b	d	a
141	142	143	144	145	146	147	148	149	150	151	152	153	154	155	156	157	158	159	160
d	c	a	d	b	d	d	a	a	c	b	c	a	c	b	a	c	d	b	a
161	162	163	164	165	166	167	168	169	170	171	172	173	174	175	176	177	178	179	180
b	c	d	b	b	d	c	a	b	d	b	a	a	c	d	b	d	a	d	d
181	182	183	184	185	186	187	188	189	190	191	192	193	194	195	196	197	198	199	200
b	b	c	c	a	b	a	b	a	c	c	c	b	a	d	a	c	b	c	a
201	202	203	204	205	206	207	208	209	210	211	212	213	214	215	216	217	218	219	220
b	d	a	a	c	b	d	b	c	a	c	a	b	b	b	a	b	c	d	c
221	222	223	224	225	226	227	228	229	230	231	232	233	234	235	236	237	238	239	240
b	a	b	b	a	d	c	b	c	a	c	a	a	c	d	b	d	a	b	a
241	242	243	244	245	246	247	248	249	250	251	252	253	254	255	256	257	258	259	260
b	c	b	c	c	a	d	d	a	b	d	b	a	a	d	d	a	a	b	b
261	262	263	264	265	266	267	268	269	270	271	272	273	274	275	276	277	278	279	280
d	a	a	c	c	a	b	b	d	b	a	d	c	b	c	c	a	c	d	c
281	282	283	284	285	286	287	288	289	290	291	292	293	294	295	296	297	298	299	300
b	d	c	b	b	b	a	d	a	b	b	c	a	c	b	a	a	c	b	d
301	302	303	304	305	306	307	308	309	310	311	312	313	314	315	316	317	318	319	320
b	c	a	d	a	b	d	c	a	c	d	a	c	a	d	b	a	b	c	d
321	322	323	324	325	326	327	328	329	330	331	332	333	334	335	336	337	338	339	340
a	c	d	d	d	c	d	b	a	c	c	b	b	b	d	a	b	d	a	d

II. True/False

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
T	F	T	F	T	F	F	F	T	T	F	F	T	T	F	F	T	F	T	T
21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40
F	T	F	T	T	F	F	T	F	F	T	F	T	T	F	T	T	F	T	F
41	42	43	44	45															
F	T	T	F	F															

III. Fill in the blanks

1	specialized knowledge, training	2	administrative, operative
3	no	4	formal
5	laying downs policies, determination of goals	6	implementation
7	goal alignment	8	agency

9	Type I	10	Davis, Schoorman and Doanldson
11	humanistic model of man	12	Reviewwing the Plan
13	Standing	14	Planning Premises
15	Identifying the work	16	Staffing
17	Human Resource Planning	18	Recruitment
19	Placement	20	Payroll
21	Selection	22	Sensitivity Training
23	Cybernatics	24	Real time or steering control
25	Management Information System	26	Break Even Analysis
27	General	28	Scalar Chain
29	Rule of Thumb	30	Rigid and inflexible
31	Communis	32	Communicator
33	Encoding	34	Decoding
35	Controlling	36	Planning
37	Establishment of Standards	38	Critical Point Control
39	Management by Exception	40	Profit Planning
41	Ongoing	42	Key Result Areas
43	Critical Point Control	44	Feed forward
45	Authority	46	Power
47	Unlimited	48	Authority
49	Human Beings	50	Upward
51	Responsibility Charting	52	Role Negotiation
53	Authority	54	Transferring
55	Centralization	56	Decentralization
57	Large	58	Motive
59	Something	60	Psychological
61	Continuous	62	Existence, Relatedness and Growth
63	Prof. Douglas McGregor	64	X
65	Abraham H. Maslow	66	Esteem by others
67	200	68	Creative Thinking
69	Simulation	70	Identifying and diagnosing the real problems
71	Routine Decisions	72	Basic Decisions
73	Routine and Repetitive	74	Organisational
75	Collective decisions	76	Variables
77	Implementation and follow up of the decisions	78	Direct
79	Programmed		