1

MARKETING MANAGEMENT

Unit Structure :

1.0 OBJECTIVES

After studying this unit the student will be able to -

- Understanding the concept of marketing management
- To understand product life cycle
- Know the importance of price place promotion strategy
- Explain about integrated marketing communication

1.1 INTRODUCTION OF MARKETING

Meaning

Marketing is a fundamental business concept that encompasses a range of activities aimed at identifying, anticipating, and satisfying customer needs and wants. It involves creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.

Definition of Marketing

PHILIP KOTLER defines marketing as "the science and art of exploring ,creating and delivering value to satisfy the needs of a target market at a profit.

1.2 -4PS OF MARKETING

The 4Ps of marketing is a marketing mix framework that was introduced by E. Jerome McCarthy in 1960. It provides a systematic approach to understanding and managing the key elements of a marketing strategy. The 4Ps stand for Product, Price, Place, and Promotion. Let's delve into each component:

1. **Product:** This refers to the tangible or intangible goods and services that a company offers to its target market. It involves understanding the features, benefits, and unique selling points of the product, as well as how it addresses the needs of the customers.

2. **Price:** Price represents the amount of money customers are willing to pay for the product or service. Setting the right price is crucial as it influences customer perception, profitability, and market positioning. Factors like production costs, competitor pricing, and perceived value play a role in determining the pricing strategy.

3. **Place:** Also known as "Distribution," this component focuses on getting the product to the right target customers at the right place and time. It involves decisions regarding the distribution channels, logistics, inventory management, and retailing strategies.

4. **Promotion:** Promotion refers to the activities undertaken to communicate and promote the product to the target audience. It includes advertising, public relations, sales promotions, direct marketing, and other communication efforts aimed at creating awareness and generating demand for the product.

The 4Ps of marketing serve as a foundation for developing an effective marketing strategy. However, with the evolution of the business landscape, the marketing mix has expanded, and newer frameworks have emerged to encompass other critical elements like People, Process, and Physical Evidence, particularly in service-oriented industries. Nonetheless, the 4Ps concept remains a valuable tool for understanding and organizing the core aspects of a marketing plan.

1.3 IMPORTANCE OF MARKETING

Marketing plays a crucial role in the success of any business or organization. Its importance lies in several key aspects that contribute to the growth and sustainability of a company. Here are some of the reasons why marketing is essential:

1. **Customer Understanding:** Marketing involves conducting market research to understand customer needs, preferences, and behaviors. This information helps companies create products and services that cater to their target audience, leading to higher customer satisfaction and loyalty.

2. **Market Positioning:** Effective marketing helps businesses position themselves in the market and differentiate their offerings from competitors. A well-defined market position helps attract the right customers and establishes a unique brand identity.

3. **Building Awareness:** Marketing activities such as advertising, social media campaigns, and content marketing help create awareness about a brand and its products or services. Increased visibility leads to potential customers recognizing the brand and considering it when making purchasing decisions.

4. **Generating Demand:** Through various promotional efforts, marketing stimulates demand for products and services. By showcasing the benefits and value of what they offer, businesses can encourage customers to make purchases.

5. **Sales Growth:** A well-executed marketing strategy can lead to increased sales and revenue. Effective marketing campaigns can attract new customers, retain existing ones, and persuade them to make repeat purchases.

6. **Customer Retention:** Marketing is not solely focused on acquiring new customers; it also involves maintaining strong relationships with existing ones. Customer retention is often more cost-effective than customer acquisition, and marketing strategies can help keep customers engaged and loyal.

7. **Adaptation to Changes:** Market conditions, consumer preferences, and industry trends are continually evolving. Marketing helps businesses stay informed about these changes and adapt their strategies accordingly to remain relevant and competitive.

8. **Innovation and New Product Development:** Marketing plays a role in the identification of opportunities for new product development or product improvements based on market needs and feedback. It facilitates the successful introduction of new products or services into the market.

9. **Profitability:** Effective marketing helps companies target the right customers and optimize their marketing efforts. This focus on the most relevant audience can lead to increased sales and improved profitability.

10. **Economic Impact:** Marketing activities drive economic growth by creating demand for products and services, leading to job creation and contributing to overall economic development.

1.4 INTRODUCTION OF PRODUCT MANAGEMENT

Meaning

Product Management is the general business practice within a company that supports and manages all the activities related to planning, developing, marketing, and launching a product. The Product Management role usually falls within the product development department.

Definition

Product management is an organizational function that guides every step of a product's lifecycle — from development to positioning and pricing — by focusing on the product and its customers first and foremost.

1.5 PRODUCT DEVELOPMENT STRATEGIES

Product development strategies are the planned approaches and methods used by a company to create, design, and introduce new products or improve existing ones. These strategies are essential for companies to stay competitive, expand their market share, and meet changing customer needs. Here are some common product development strategies:

1. **Market Research and Consumer Insights:** Companies conduct market research and gather consumer insights to identify potential product opportunities and understand customer preferences and pain points.

2. **New Product Development (NPD):** This strategy involves the creation of entirely new products that are not currently offered by the company. NPD may result from innovative ideas, emerging technologies, or identified gaps in the market.

3. **Product Improvements and Upgrades:** Enhancing existing products based on customer feedback and technological advancements can lead to improved features, performance, or quality.

4. **Line Extensions:** Companies can introduce line extensions by adding new variations or flavors to an existing product line. This strategy leverages the existing brand recognition to launch new offerings.

5. **Brand Licensing and Partnerships:** Partnering with other companies or licensing existing brands can help in the development of new products or leveraging existing brand equity in different product categories.

6. **Product Diversification:** Diversification involves expanding the product portfolio into new markets or industries. This strategy can help reduce risk and create new revenue streams.

7. **Product Lifecycle Management:** Strategically managing products throughout their lifecycle, from introduction to eventual decline, allows companies to plan for updates, replacements, or product discontinuation.

8. **Reverse Engineering and Benchmarking:** Companies may study competitors' products through reverse engineering or benchmarking to understand their strengths and weaknesses and identify areas for improvement.

9. **Rapid Prototyping and Iterative Development:** Using rapid prototyping techniques, companies can quickly develop and test product concepts, allowing for iterative improvements based on user feedback.

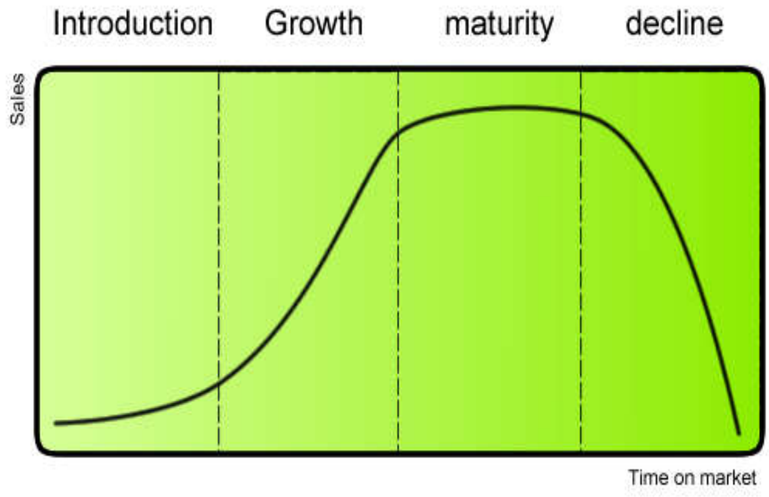
10. **Cost Leadership and Value Engineering:** Developing products with a focus on cost efficiency while maintaining quality and meeting customer needs can give a competitive edge.

Effective product development strategies involve a combination of creativity, market understanding, technical expertise, and responsiveness to customer demands. By implementing successful product development strategies, companies can maintain their competitive edge, sustain growth, and deliver value to their target markets.

1.6 PRODUCT LIFE CYCLE

Product Life Cycle :

The product life cycle refers to the different stages that a product goes through over time, from its initial introduction to its eventual decline or discontinuation. The product life cycle consists of four main stages:



1. **Introduction:** At the introduction stage, the product is launched into the market. It is a period of slow sales growth as consumers become aware of the brand. Companies often invest heavily in marketing and advertising to build brand awareness and establish a market presence. Profits during this stage are usually low or negative due to high marketing expenses and limited sales.

2. **Growth:** During the growth stage, the product experiences rapid sales growth as it gains acceptance in the market. Consumer demand increases, and competitors may enter the market. Companies may expand distribution channels and product variations to meet growing demand. Profits start to improve in this stage as sales increase and economies of scale are achieved.

3. **Maturity:** The maturity stage is characterized by stable sales and market saturation. The product has reached its peak in terms of market acceptance, and competition becomes intense. Companies focus on product differentiation, customer loyalty programs, and cost-cutting measures to maintain market share. Profits may level off or decline slightly due to competitive pressures.

4. **Decline:** In the decline stage, the product faces decreasing sales and market share. Consumer preferences may shift to newer or more innovative products. Companies may choose to discontinue the brand or target niche markets to extend its life. Profits decline sharply during this stage, and companies need to carefully manage costs.

1.7 BRANDING

"Branding is endowing products and services with the power of a brand" (Kotler & Keller, 2015)

Branding is the process of giving a meaning to specific organization, company, products or services by creating and shaping a brand in consumers' minds. It is a strategy designed by organizations to help people to quickly identify and experience their brand, and give them a reason to choose their products over the competition's, by clarifying what this particular brand is and is not.

The objective is to attract and retain loyal customers and other stakeholders by delivering a product that is always aligned with what the brand promises.

1.8 FACTORS INFLUENCING BRANDING

Branding in marketing is influenced by a variety of factors, all of which contribute to shaping how a brand is perceived by its target audience. Here are some key factors that influence branding in marketing:

1. **Target Audience :** Understanding your target audience's preferences, needs, values, and behaviors is crucial in shaping your brand. Your branding efforts should resonate with your intended customer base.

2. **Brand Identity :** This encompasses your brand's visual elements (logo, colors, typography) and its personality (tone of voice, values, messaging). A strong and consistent brand identity helps create recognition and differentiation.

3. **Positioning :** How you position your brand in relation to competitors in the market can greatly influence branding. Are you the luxury option, the affordable choice, or something else? This impacts how customers perceive your brand.

4. **Value Proposition :** Your brand should clearly communicate the unique value it offers to customers. What problems do you solve? How do you improve customers' lives? Your value proposition shapes your brand's purpose.

5. **Consistency :** Consistency across all touchpoints is key to successful branding. From advertising to customer service to product quality, maintaining consistency builds trust and reliability.

6. **Emotion and Storytelling :** Emotional connections can create strong brand loyalty. Storytelling that resonates with customers' emotions can enhance brand engagement and long-term relationships.

7. **Customer Experience :** Every interaction a customer has with your brand contributes to its perception. Positive experiences lead to positive brand associations, and vice versa.

8. **Innovation and Adaptation :** Brands that innovate and adapt to changing market trends and customer needs can maintain relevance and a competitive edge.

9. **Cultural and Social Trends :** Brands that align with or tap into current cultural and social trends can capture attention and connect with consumers on a deeper level.

10. **Ethics and Values :** In today's socially conscious world, a brand's ethical stance and values can strongly influence consumer perception and loyalty.

11. **Packaging and Presentation :** The way your products are packaged and presented can impact how they're perceived on the shelves and in the minds of consumers.

12. **Marketing Channels :** The channels you use to reach your audience (social media, traditional advertising, influencer marketing, etc.) affect how your brand is seen and interacted with.

13. **Competitor Analysis :** Understanding your competitors' branding strategies can help you differentiate and position your brand effectively.

14. **Customer Feedback :** Listening to customer feedback and adapting your brand accordingly demonstrates responsiveness and a commitment to improvement.

15. **Long-Term Consistency:** Brands that endure often have a consistent core message and identity over time, even as they evolve to stay relevant.

Remember, successful branding is a combination of these factors working together to create a coherent and compelling brand image that resonates with your target audience.

1.9 INTRODUCTION OF PRICE MANAGEMENT

Price management refers to the strategic process of setting, adjusting, and optimizing prices for products or services in order to achieve specific business objectives. It is a critical component of marketing and business strategy, as pricing directly impacts a company's revenue, profitability, market positioning, and customer perception. Effective price management involves a deep understanding of market dynamics, customer behavior, competitive landscape, and internal cost structures. In this introduction, we will explore the key concepts and significance of price management in today's business environment.

1. **Pricing as a Strategic Tool :** Price management goes beyond simply assigning a monetary value to a product. It involves considering the broader business goals and using pricing strategically to achieve them. Whether a company aims to capture market share, maximize profits, enter new markets, or convey a specific brand image, pricing decisions play a pivotal role in realizing these objectives.

2. **Factors Influencing Pricing :** Numerous internal and external factors influence pricing decisions. These include production costs, competitor pricing, customer willingness to pay, market demand, economic conditions, seasonality, regulatory constraints, and more. Effective price management requires a comprehensive analysis of these factors to determine the optimal price point.

3. **Value-Based Pricing :** One prevalent approach in price management is value-based pricing, where prices are set based on the perceived value of a product or service to the customer. This approach involves understanding how customers perceive the benefits and advantages offered by the product and aligning the price accordingly.

4. **Dynamic Pricing :** Dynamic pricing involves adjusting prices in real-time based on changing market conditions, demand fluctuations, competitor actions, or other variables. This approach is often employed in industries such as e-commerce, travel, and entertainment, where prices can vary frequently.

5. **Price Elasticity :** Price elasticity measures how changes in price affect the quantity demanded of a product. Understanding price elasticity helps companies predict how customers will respond to price changes and make informed decisions about pricing adjustments.

6. **Psychological Pricing :** Psychological pricing takes into account the psychological impact of pricing on consumer perception. It considers strategies such as using charm pricing (ending prices in "9" or "99"), tiered pricing, or bundle pricing to influence purchasing decisions.

7. **Competitive Pricing :**Analyzing and responding to competitor pricing is a crucial aspect of price management. Companies need to position their prices relative to competitors' prices to remain competitive while maintaining their desired market positioning.

8. **Pricing Strategies :** Various pricing strategies, such as penetration pricing (setting a low initial price to quickly gain market share), skimming pricing (setting a high initial price and gradually lowering it), and value pricing (emphasizing value for money), can be employed based on the business's goals and the product's life cycle.

9. **Price Optimization Tools :** Advancements in technology have led to the development of sophisticated price optimization tools and software. These tools use data analytics, algorithms, and machine learning to analyze market trends, customer behavior, and competitor pricing, helping businesses make data-driven pricing decisions.

In conclusion, price management is a dynamic and multifaceted discipline that requires a deep understanding of market dynamics, consumer behavior, and business objectives. It is a strategic tool that can significantly impact a company's success by influencing customer perception, market positioning, and financial performance. Effective price management involves a continuous process of analysis, adjustment, and optimization to ensure that prices align with business goals and market realities.

1.10 FACTORS AFFECTING PRICING DECISIONS

Pricing decisions are critical in determining the success and profitability of a product or service. Various internal and external factors influence pricing decisions. Some of the key factors include:

1. **Cost of Production:** The cost of producing the product or delivering the service is a fundamental factor in setting the price. Companies need to ensure that the selling price covers the production costs and allows for a reasonable profit margin.

2. **Competition:** The competitive landscape plays a significant role in pricing decisions. Companies must consider the prices set by competitors for similar products or services. Pricing too high may result in losing customers to competitors, while pricing too low may lead to lower profits.

3. **Customer Perceptions:** Customer perception of value greatly influences pricing decisions. Companies need to understand how their target customers perceive the product's benefits and whether they are willing to pay a premium for it.

4. **Market Demand:** Price elasticity of demand, i.e., how sensitive customer demand is to changes in price, impacts pricing decisions. In a highly competitive market with elastic demand, lowering prices may lead to increased sales.

5. **Positioning Strategy:** The intended market positioning of the product also affects pricing decisions. A premium pricing strategy positions the product as high-quality, while a lower price may target price-sensitive customers.

6. **Objectives:** The company's pricing objectives can vary. It may aim for market share growth, maximizing short-term profits, or long-term brand building. Each objective may require a different pricing approach.

7. **Legal and Ethical Considerations:** Pricing decisions must comply with legal regulations and ethical standards. Anti-competitive practices, price discrimination, and predatory pricing are examples of illegal pricing activities.

8. **Product Life Cycle:** Pricing strategies may differ at different stages of the product life cycle. For instance, introductory pricing may involve setting lower prices to gain market share, while mature products may offer discounts to maintain sales.

9. **External Economic Factors:** Economic conditions, inflation rates, and exchange rates can impact pricing decisions, especially in international markets.

10. **Channel Relationships:** If products are sold through intermediaries, such as distributors or retailers, their margins and markups will influence the final retail price.

By carefully considering these factors, companies can set appropriate prices that align with their business goals, target customer preferences, and market conditions. Pricing decisions require ongoing evaluation and adjustment to remain competitive and profitable.

1.11 PLACE DISTRIBUTION MANAGEMENT:

Meaning

Place distribution management, also known as channel distribution management, refers to the process of planning, implementing, and controlling the efficient and effective movement of products or services from the producer to the end consumer. It involves managing the distribution channels, intermediaries, logistics, and activities to ensure that products reach the right place at the right time and in the right condition.

Definition

Distribution management involves moving finished goods from a manufacturer or supplier to the so-called end user. The process includes warehousing, inventory management, packing, shipping, and delivery.

1.12 FACTORS GOVERNING DISTRIBUTION DECISION

Several factors influence distribution decisions for a company. Some of the key factors include:

1. **Nature of the Product:** The characteristics of the product, such as perishability, fragility, and complexity, influence the choice of distribution channel. Some products may require specialized handling or storage, which can impact the selection of intermediaries.

2. **Target Market:** Understanding the geographic location and preferences of the target market helps in determining the most efficient distribution channels to reach the intended customers.

3. **Competition:** Analyzing how competitors distribute their products can provide insights into the effectiveness of different distribution channels in the industry.

4. **Company Resources:** The financial, logistical, and operational capabilities of the company influence its ability to manage different distribution channels effectively.

5. **Customer Expectations:** Customer expectations regarding product availability, delivery times, and convenience play a significant role in distribution decisions.

6. **Market Reach:** Companies need to evaluate the coverage and reach provided by different distribution channels to ensure maximum market penetration.

7. **Intermediaries:** The availability, reliability, and suitability of intermediaries, such as wholesalers, retailers, and distributors, impact distribution decisions.

1.13 TYPES OF DISTRIBUTION CHANNELS

1. **Direct Distribution:** In this channel, the producer sells products directly to the end consumer without intermediaries. It can include selling through company-owned retail stores, e-commerce platforms, or direct sales representatives.

2. **Indirect Distribution:** Indirect distribution involves the use of intermediaries to reach the end consumer. There are three main types of indirect channels:

   a. **Retail Distribution:** Products are sold through retail stores that directly serve consumers.

   b. **Wholesale Distribution:** Products are sold in bulk to wholesalers who then distribute them to retailers.

   c. **Distributor Distribution:** Independent distributors purchase products from the producer and resell them to retailers or end consumers.

3. **Dual Distribution:** Some companies use a combination of direct and indirect distribution channels. They sell products directly to consumers through their stores or website while also using intermediaries for wider market coverage.

4. **Exclusive Distribution:** This strategy limits the number of retailers or distributors authorized to sell a particular product in a specific geographic area. It is common for luxury or premium products.

5. **Intensive Distribution:** Intensive distribution aims to make a product available in as many retail outlets as possible, increasing its accessibility to consumers.

6. **Selective Distribution:** Selective distribution involves using a limited number of retailers or distributors who are carefully selected based on specific criteria.

Choosing the right distribution channel and effectively managing it is essential for ensuring product availability, customer satisfaction, and market success. It requires continuous evaluation and adjustments to align with changing market dynamics and consumer preferences.

1.14 PROMOTION MANAGEMENT

Meaning

Promotion management refers to the process of planning, implementing, and coordinating various promotional activities and strategies to communicate the value of a product or service to the target audience. The primary goal of promotion management is to create awareness, generate interest, stimulate demand, and ultimately persuade customers to make a purchase. It involves utilizing various promotional tools and techniques to reach the intended audience effectively and achieve marketing objectives.

1.15 PROMOTION STRATEGIES:

Promotion strategies are the planned approaches and methods used by businesses to promote their products or services to the target market. Several promotion strategies can be employed, including:

1. **Advertising:** Advertising is a paid form of communication through various media channels such as television, radio, print, online platforms, and social media. It aims to reach a broad audience and create brand awareness.

2. **Sales Promotion:** Sales promotion involves short-term incentives and offers, such as discounts, coupons, contests, giveaways, or loyalty programs, to encourage immediate purchases and drive sales.

3. **Public Relations (PR):** PR activities focus on managing the company's public image, building positive relationships with the media and the public, and handling crises or negative publicity.

4. **Personal Selling:** Personal selling involves direct communication between a salesperson and potential customers. It allows for personalized interactions, addressing specific customer needs, and building strong customer relationships.

5. **Direct Marketing:** Direct marketing involves reaching out to individual customers through channels like email, direct mail, telemarketing, or text messages. It allows for targeted communication and immediate response.

6. **Sponsorship and Event Marketing:** Companies may sponsor events or engage in event marketing to associate their brand with specific experiences or causes and connect with the target audience.

7. **Influencer Marketing:** This strategy involves collaborating with influencers or individuals with significant online followings to promote products or services to their audience.

8. **Content Marketing:** Content marketing focuses on creating valuable and relevant content, such as blogs, articles, videos, or social media posts, to attract and engage the target audience.

1.16 INTEGRATED MARKETINGCOMMUNICATION (IMC)

Integrated Marketing Communication (IMC) is a strategic approach that involves coordinating all marketing communication efforts to deliver a consistent and unified message to the target audience. The idea behind IMC is to ensure that all promotional activities work together harmoniously, reinforcing the brand's message and enhancing its impact on customers.

IMC considers various marketing communication channels, including advertising, public relations, direct marketing, social media, personal selling, and more. By integrating these channels, a company can create a cohesive and seamless communication experience for customers, leading to better brand recall, customer engagement, and improved marketing effectiveness.

The key benefits of IMC include a clear and unified brand message, optimized resource allocation, improved communication efficiency, and enhanced customer experience. Successful implementation of IMC requires careful planning, coordination, and evaluation of all promotional activities to align with the overall marketing objectives.

1.18 CASE STUDIES 1:- 4 ‘ PS OF MARKETING

Samsung Marketing (4’Ps):

Product: The product can be classified into five categories & they are:

- Mobile Devices
- Samsung Home Appliances
- TV/AV
- Information Technology
- Memory/Storage

Price: Samsung is market leader in smart phones and is a dominant player in market for home appliances. It uses two pricing schemes which are:

- Skimming Price
- Competitive Price

Place: Samsung sells directly to the retailers and service dealers. And due to this strategy, only service dealers are responsible for the corporate sales. Samsung also distributes its product using a single distribution company in a particular location that further distributes the products to other locations.

Promotion: Promotion is a strong pillar in a marketing mix of the company. Samsung believes that advertising the best form of promotion to engage potential consumers and position the brand. Samsung promotes new products using newspaper and digital media.

Besides advertising, Samsung also uses different promotional tactics to make customers buy the product .Samsung also sponsors major events. Samsung offers heavy discounts during nation festivals. This concludes the Samsung marketing mix analysis.

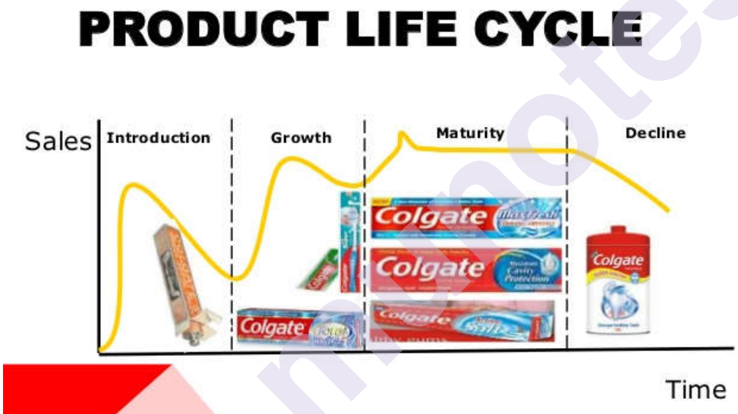
Case studies 2 product management

1- Rules of Flow for Product Management: an AirBnB Case Study

"Engagement" is a term that is so overused in product management that it has almost lost its meaning. So often I've heard from teams, "We'll measure the success of this test with engagement," which could mean anything from feature click through to bounce to we-aren't-really-sure-this-will-drive-conversion-so-we're-hedging-our-bet. Underneath, the reason this term has been co-opted and jargonized is that genuine, productive engagement can be ramps toward long term customer loyalty. And loyalty pays off: a loyalty increase of 7% can boost lifetime profits per customer by as much as 85%, and a loyalty increase of 3% can correlate to a 10% cost reduction (Brand Keys).

Case studies 3 product life cycle

Eg.colgate



Case studies :**4 price management on starbucksedya and paiks coffee**

Using the PSM(price sensitivity management) technique, this study attempted to develop pricing strategy based on an understanding about customer perceived price sensitivity of Americano coffees in three coffee franchises(Starbucks, Edya and Paik's Coffee). The data were collected from 210 customers during their visits to the three coffee chain stores in the Seoul metropolitan area from April 20th to May 15th, 2016. The results revealed that the current prices of Americano for three brands were within the range of an acceptable price. Among the three brands, Edya revealed the widest price stress, the narrowest acceptable price range, and the biggest stress factor while Starbucks revealed the lowest cumulative rate of indifference to price. In the case of Paik's Coffee, respondents were second place in acceptable price range and had the least price sensitivity in the cumulative rate of indifference to price, price stress, and the general stress factor. In conclusion, the price sensitivity of Americano at the Edya chain was the highest followed by Starbucks and Paik's Coffee. This study concluded with implications of the research findings and suggestions for future research areas.

Case studies on place management

FMCG Case Study: Nestle:

A multinational food and beverage firm called Nestle makes a variety of goods, such as coffee, chocolate, and baby food. Managing the company's distribution channels was difficult, especially in emerging regions with its numerous small merchants and underdeveloped infrastructure.

Nestle created a distribution management system that gave them end-to-end insight and control over its distribution routes in order to overcome these difficulties. Nestle was able to control inventory levels, track shipments, and keep an eye on distribution efficiency thanks to the system.

Nestle was able to enhance product availability, lessen stock-outs, and streamline its supply chain as a result. The business also obtained knowledge about its distribution systems, which helped it spot chances to boost productivity and cut expenses.

Case studies

Integrated Marketing Communication Case Study #1 - Microsoft

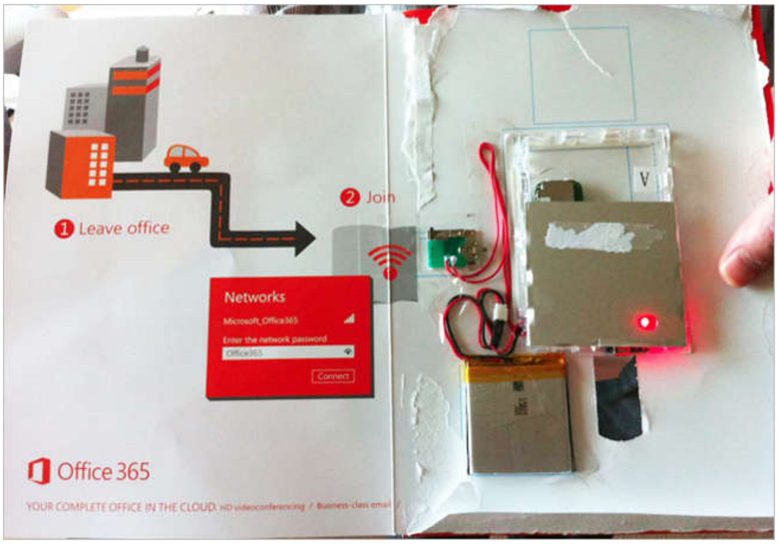
Microsoft Corporation is an American technology company. It develops, manufactures, licenses, supports and sells computer software, consumer electronics, personal computers, and related services.

Their mission is to 'empower every person and every organization on the planet to achieve more.'

Microsoft's Integrated Marketing Communication Channels:

Print and media are a pivotal part of Microsoft's marketing strategy. Microsoft spends upwards of $1.5 Billion for Print and media alone.

One of its ingenious print advertising campaigns for Microsoft's Office 365 software includes the WiFi-enabled promotion on the Forbes magazine.



A sleek router with a battery placed within the magazine gave its subscribers free wifi for 15 days. This gimmick ensured that readers had to retain the magazine him at all times and contributed multiple exposures of the ad to the reader.

Currently, Microsoft is undertaking a slow shift from traditional media to social media and other online platforms.

1.14 SUMMARY

In summary, marketing management is a dynamic process that involves a range of activities aimed at creating, communicating, and delivering value to customers. It requires a deep understanding of markets, customers, and effective strategies to drive growth and achieve organizational objectives.

1.15 QUESTIONS

Fill in the blanks :

1) In the _______ stage, the product phases decreasing sales and market share

   A) growth B) decline C) maturity D) introduction

2) _______ place a crucial role in the success of any business or organization

   A) Demand B) Branding C) Marketing D) Management

3) Place distribution management also known as _______ distribution management

   A) channel B) factors C) services D) resources

4) Product are sold in bulk to _______

A) wholesalers B) retailers c) distributors D) consumers

5) _______ is a paid form of communication

A) personal selling B) Advertising C) sampling D) Branding

True or False :

1) Sales promotion involves short termincentives and offers-true
2) Content marketing focuses on creating value and living content such as blogs - true
3) Integrated marketing communication is an unstaticapproach- false
4) Growth stage are same at different stages of the product life cycle- false
5) Marketing is a fundamental business concept that encompasses a range of activities- true

Match the column

A	B
1.marketing mix	a. supply
2.decline	b. 4 p's
3.philip Kotler	c. last stage
4.branding	d. marketing
5.demand	e. name

ANS--- 1. b 2. C 3. D 4. E 5. A

Answer in brief :

1. What arethe 4 P'sofmarketing ?
2. Explain product lifecycle with the help of a diagram.
3. What are the factors governing distribution decision in place distribution management?
4. Write a noteon
   - imc
   - importance of marketing
   - branding
   - promotions strategies
   - decline stage

1.16 REFERENCES

1. **"Marketing Management" by Philip Kotler and Kevin Lane Keller** - Widely regarded as a foundational textbook, this comprehensive resource covers all aspects of marketing management, including strategic planning, market analysis, consumer behavior, branding, and more.

2. **"Principles of Marketing" by Philip Kotler and Gary Armstrong** - Another seminal work by Philip Kotler, this book offers a solid introduction to the principles and practices of modern marketing.

3. **"Marketing Management: A Strategic Decision-Making Approach" by John W. Mullins and Orville C. Walker Jr.** - This book emphasizes strategic decision-making processes in marketing management, helping readers understand how to create and execute effective marketing strategies.

4. **"Contemporary Marketing" by Louis E. Boone and David L. Kurtz** - A comprehensive text that covers a wide range of marketing topics, from consumer behavior and market segmentation to digital marketing and global marketing.

5. **"Marketing Metrics: The Definitive Guide to Measuring Marketing Performance" by Paul W. Farris, Neil T. Bendle, Phillip E. Pfeifer, and David J. Reibstein** - This book focuses on the measurement and analysis of marketing performance, providing valuable insights into assessing the effectiveness of marketing strategies.

6. **"Marketing Management: Knowledge and Skills" by J. Paul Peter and James H. Donnelly Jr.** - This textbook offers a solid foundation in marketing concepts, strategies, and skills, with a practical approach to marketing management.

7. **"Marketing Insights from A to Z: 80 Concepts Every Manager Needs to Know" by Philip Kotler** - In this book, Philip Kotler presents a collection of essential marketing concepts and insights, making it a handy reference for marketing managers.

8. **"Marketing Management Journal"** - A reputable academic journal that publishes research articles and case studies related to marketing management. It provides insights into current trends, strategies, and best practices in the field.

9. **"Journal of Marketing"** - A leading academic journal in the marketing discipline, publishing research on a wide range of marketing topics, including consumer behavior, branding, marketing strategy, and more.

10. **"Harvard Business Review"** - While not exclusively focused on marketing, this influential publication often features articles and case studies related to marketing strategy, consumer trends, and market analysis.

11. **"Journal of Consumer Research"** - This academic journal focuses on consumer behavior research, providing valuable insights into understanding and influencing consumer choices.

12. **"Marketing Science"** - A journal that publishes research at the intersection of marketing and quantitative analysis, offering insights into marketing modeling, decision-making, and data-driven strategies

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2

PRODUCTION MANAGEMENT

Unit Structure :

2.0 OBJECTIVES

- To study about production management
- To understand about productivity movement
- To know about inventory management

2.1 INTRODUCTION

Production Management

Meaning

Production management, also known as operations management or manufacturing management, refers to the process of planning, organizing, and controlling the resources and activities involved in the conversion of raw materials and labor into finished goods or services. It involves overseeing the production process to ensure efficiency, quality, and timely delivery of products or services while optimizing resources and minimizing costs.

Definition

According to E.L.Brech, "Production management is the process of effective planning and regulationg the operations of that section of an enterprise which is responsible for the actual transformation of materials into finished products.

2.2 SCOPE OF PRODUCTION MANAGEMENT

The scope of production management at Company XYZ includes:

1. **Production Planning:** Developing production schedules and capacity planning to ensure optimal utilization of resources and timely delivery of products.

2. **Inventory Management:** Monitoring inventory levels to avoid stockouts and excess inventory, optimizing storage space, and minimizing carrying costs.

3. **Quality Control:** Implementing quality assurance measures to meet product specifications and minimize defects.

4. **Supply Chain Management:** Coordinating with suppliers and logistics partners to ensure a smooth flow of materials and timely deliveries.

5. **Production Process Improvement:** Identifying opportunities for process optimization and implementing continuous improvement initiatives to enhance productivity and efficiency.

2.3 STEPS IN PRODUCTION PLANNING AND CONTROL

1. **Demand Forecasting:** The production management team analyse market demand and customer orders to forecast future demand accurately.

2. **Master Production Scheduling:** Based on demand forecasts, a master production schedule is created, outlining the production quantities and schedules.

3. **Material Requirement Planning (MRP):** The team uses MRP techniques to determine the quantity and timing of raw materials required for production.

4. **Capacity Planning:** Assessing the production capacity and aligning it with demand to avoid overproduction or underproduction.

5. **Production Execution:** Supervising and coordinating the actual production process, ensuring that it adheres to the planned schedules and quality standards.

6. **Quality Control:** Conducting regular quality checks at various stages of production to identify and rectify defects.

7. **Inventory Management:** Maintaining optimum inventory levels to ensure uninterrupted production while minimizing carrying costs.

2.4 MEANING OF PRODUCTIVITY

Meaning

Productivity is a measure of efficiency and output in relation to the resources utilized in a production process. It reflects the ability to produce more output with the same or fewer resources.

Definition

2.5 MEASURES TO INCREASE PRODUCTIVITY

At Company XYZ, the management identifies measures to increase productivity, such as:

1. **Automation and Technology:** Investing in automated machinery and advanced technology to streamline production processes and reduce manual labor.

2. **Employee Training and Development:** Providing regular training and upskilling opportunities to the workforce to enhance their efficiency and expertise.

3. **Process Optimization:** Analyzing production workflows and identifying bottlenecks or inefficiencies to optimize processes.

4. **Quality Improvement:** Emphasizing quality control and minimizing defects to reduce rework and waste, resulting in higher output.

5. **Cross-Functional Collaboration:** Encouraging collaboration between different departments to foster innovation and problem-solving.

2.6 PRODUCTIVITY MOVEMENT IN INDIA

The productivity movement in India refers to a series of initiatives, strategies, and efforts aimed at improving and enhancing productivity across various sectors of the economy. These movements have been driven by both government and industry bodies with the goal of boosting economic growth, competitiveness, and overall development. Here are some key points and phases of the productivity movement in India:

1. **Post-Independence Era:** The productivity movement in India gained momentum after independence in 1947. The government recognized the need to enhance industrial productivity for economic development. The National Productivity Council (NPC) was established in 1958 as an autonomous body under the Ministry of Industry to promote productivity awareness and practices.

2. **Green Revolution and Agricultural Productivity:** In the 1960s and 1970s, the Green Revolution aimed at increasing agricultural productivity through the introduction of high-yield crop varieties, modern farming techniques, and improved irrigation methods. This movement significantly boosted food production and helped alleviate food scarcity.

3. **Quality Circles and Total Quality Management (TQM):** In the 1980s, the concept of quality circles gained prominence. It involved involving workers in decision-making and problem-solving to enhance productivity and quality. The introduction of Total Quality Management (TQM) practices aimed at improving processes, reducing defects, and enhancing overall efficiency.

4. **Liberalization and Globalization:** The economic reforms of the 1990s brought about a shift towards liberalization and globalization. These changes emphasized efficiency, competitiveness, and productivity improvements across industries to compete effectively in the global market.

5. **Information Technology (IT) and Service Sector Productivity:** With the growth of the IT industry and the service sector, the productivity movement extended to these areas. India's success in IT and bs outsourcing (BPO) waslargely driven by improvements in productivity, quality, and process optimization.

6. **Lean and Six Sigma:** Lean management and Six Sigma methodologies gained popularity in India during the 2000s. These methodologies aimed at reducing waste, improving efficiency, and enhancing product and service quality.

7. **Digital Transformation and Industry 4.0:** Recent years have seen a focus on leveraging digital technologies, automation, and data analytics to drive productivity improvements across industries. The "Make in India" initiative and the push for "Industry 4.0" concepts align with this objective.

8. **Sustainability and Inclusive Growth:** In more recent times, there has been an emphasis on sustainable productivity growth that considers social and environmental factors. Inclusive growth models aim at ensuring that the benefits of increased productivity reach all segments of society.

9. **Skill Development and Human Capital:** The productivity movement has also recognized the importance of skill development and human capital. Efforts are being made to enhance the skills of the workforce to contribute effectively to productivity improvement.

10. **Government Initiatives:** The Indian government continues to promote productivity through various initiatives, policies, and campaigns. These include programs to enhance manufacturing

competitiveness, boost agricultural productivity, and promote innovation and entrepreneurship.

It's important to note that the productivity movement in India is ongoing and continues to evolve as the country seeks to enhance its economic growth, competitiveness, and overall development. The National Productivity Council (NPC) remains a key institution driving productivity-related initiatives and awareness in the country.

2.7 QUALITY MANAGEMENT

Meaning

Quality management includes the determination of a quality policy, creating and implementing quality planning and assurance, and quality control and quality improvement

2.8 TOTAL QUALITY MANAGEMENT (TQM)

Meaning

Total Quality Management (TQM) is a comprehensive management philosophy and approach that emphasizes continuous improvement, customer focus, and the involvement of all employees in the pursuit of quality excellence. TQM aims to create a culture where every member of the organization is committed to delivering high-quality products or services and continuously seeking ways to enhance processes.

Definition

“TQM is a strategic approach to produce the best product and service possible through constant innovation.” —Atkinson. “TQM is a management system, not a series of programs, it is a system that puts customer satisfaction before profit.

Key principles of TQM include:

- **Customer Focus:** Identifying and meeting customer needs and expectations is the central focus of TQM.
- **Continuous Improvement:** Encouraging ongoing improvement in all aspects of the organization, from processes to products, based on feedback and data analysis.
- **Employee Involvement:** Involving employees at all levels in decision-making and problem-solving to foster a sense of ownership and commitment to quality.
- **Process Orientation:** Emphasizing the importance of well-defined and efficient processes to consistently deliver quality outcomes.
- **Data-Driven Decision Making:** Using data and metrics to make informed decisions and identify areas for improvement.

Quality Circles :

Quality Circles are small groups of employees who voluntarily come together to identify, analyze, and solve work-related problems or issues that affect quality and productivity. These circles promote employee involvement and empowerment, allowing them to contribute ideas and solutions to improve processes and eliminate defects.

Quality Circles typically follow a structured approach, including problem identification, data analysis, brainstorming solutions, implementation, and evaluation. They are an integral part of TQM and help in fostering a culture of continuous improvement within an organization.

2.9 ISO 9000 AND ISO 14000

ISO 9000 and ISO 14000 are two separate sets of international standards that address different aspects of management and environmental practices within organizations. Let's take a closer look at each of these standards:

ISO 9000: Quality Management System

The ISO 9000 series of standards focuses on quality management systems (QMS) and provides guidelines for organizations to ensure that their products and services consistently meet customer requirements and enhance customer satisfaction. The standards are designed to help organizations establish, implement, and continually improve their quality management processes. The key components of ISO 9000 include:

1. **ISO 9001:** This is the core standard within the ISO 9000 series. It specifies the requirements for a quality management system that an organization can use to demonstrate its ability to consistently provide products and services that meet customer and regulatory requirements.

2. **ISO 9004:** This standard provides guidance for organizations to achieve sustained success through the effective implementation of a quality management approach. It focuses on continuous improvement, self-assessment, and exceeding customer expectations.

3. **Benefits:** Implementing ISO 9000 standards can lead to improved product and service quality, increased customer satisfaction, enhanced organizational efficiency, and better communication and coordination within the organization.

ISO 14000: Environmental Management System

The ISO 14000 series of standards focuses on environmental management systems (EMS) and provides guidance for organizations to effectively manage their environmental responsibilities and minimize their impact on the environment. The standards help organizations establish and maintain systematic approaches to environmental management. Key components of ISO 14000 include:

1. **ISO 14001:** This is the core standard within the ISO 14000 series. It specifies the requirements for an environmental management system that an organization can use to manage its environmental responsibilities in a systematic manner.

2. **ISO 14004:** This standard provides general guidelines on how to establish, implement, maintain, and improve an environmental management system. It offers practical insights into the processes involved.

3. **Benefits:** Implementing ISO 14000 standards can lead to reduced environmental impact, improved regulatory compliance, cost savings through more efficient resource use, and enhanced public image by demonstrating a commitment to environmental responsibility.

Both ISO 9000 and ISO 14000 standards provide frameworks for organizations to establish systematic approaches to management (quality and environmental, respectively) that contribute to better overall performance and sustainability. Organizations often choose to implement these standards to improve their operations, enhance customer satisfaction, and demonstrate their commitment to quality and environmental responsibility.

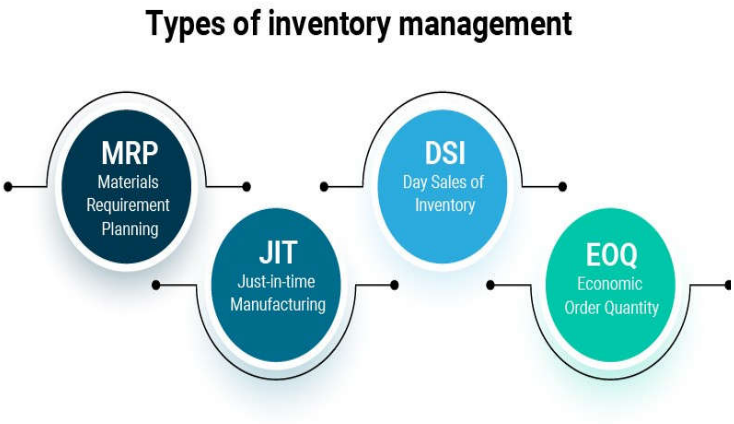
2.10 INVENTORY MANAGEMENT

Meaning

Inventory management refers to the process of ordering, storing, using, and selling a company's inventory. This includes the management of raw materials, components, and finished products, as well as warehousing and processing of such items.

METHODS OF INVENTORY MANAGEMENT

Inventory management tries to efficiently streamline inventories to avoid both gluts and shortages. Four major inventory management methods include just-in-time management (JIT), materials requirement planning (MRP), economic order quantity (EOQ) , and days sales of inventory



METHODS

Based on the type of products or businesses there are some inventory management procedures. Some of the procedures are materials requirement planning (MRP), just-in-time (JIT) manufacturing, day sales of inventory (DSI) and economic order quantity (EOQ).

MRP (materials requirement planning)

This inventory management procedure is considered as sales-forecast dependent. In this term, it mainly focuses on monitoring accurate sales records of manufacturing products to enable appropriate inventory needs of the business. Along with this, it is also useful for ensuring the communication regarding material supply on time. Besides this, the inability for presenting accurate inventory plans and forecast sales has benefited from the application of the MRP procedure.

DSI (day sales of inventory)

It is a financial ratio. DSI mainly indicates the average time in a day that an organization takes to turn its inventory into sales including goods and work progress. Additionally, it is also known as average age of inventory, inventory outstanding and also days in inventory (DII). These are interpreted in multiple ways. The prime feature of the DSI procedure is to indicate liquid inventory management. Moreover, the figure of liquid inventory represents what the stock of a company could stay for how many days. In this context, a lower DSI indicates a shortened inventory clear-off duration, whereas the average DSI varies across different industries.

JIT (just-in-time)

This method of inventory management permits organizations for reducing waste and saving money by keeping records of inventory that is required for selling as well as producing products. JIT also helps in reducing insurance and storage costs along with liquidating costs or excess inventory discarding efficiently. On the other hand, to some extent, JIT is considered risky. In this term, it can be explained that if unexpectedly demand increases, then the manufacturer may not be able to fulfill that properly due to limited inventory. Therefore, it will damage the reputation of that organization as it will be unable to meet consumer demand spikes. Moreover, it will also be responsible for declining the competitive advantage of a company across the markets.

EOQ (economic order quantity)

This type of inventory management procedure is mainly applied to calculate unit numbers of a business that should be added to its inventory. It is also associated with batch order in terms of reducing total inventory costs by assuming constant consumer demands as well. Additionally, EOQ also includes the setup and holding costs of an organization's inventory. This inventory procedure is effective for ensuring adequate inventory amounts per batch order. Therefore, it helps a company to maintain a record for batch orders and helps to avoid excessive and frequent ordering issues simultaneously. Besides this, it assumes a trade-off between inventory setup costs and inventory holding costs. Moreover, by determining both inventory setup as well as holding costs, the total inventory costs of an organization can be reduced.

2.11 SUMMARY

In essence, production management is a multidisciplinary field that involves strategic planning, resource management, process optimization, quality control, and continuous improvement. It plays a vital role in achieving operational efficiency, delivering high-quality products or services, and contributing to the overall success of a business

Case Study: Optimizing Production Processes in a Manufacturing Company Background: ABC Manufacturing is a medium-sized company that produces automotive parts. The company has been facing challenges with its production processes, including production delays, high levels of scrap and rework, and increasing costs. The management team is concerned about maintaining competitiveness and meeting customer demands while improving overall efficiency.

Challenges:

1. **Inefficient Workflow:** The production workflow is not well-organized, leading to bottlenecks and idle times at certain stages.

2. **Quality Issues:** The company experiences a high rate of defects, leading to increased scrap, rework, and customer complaints.

3. **Resource Utilization:** There is a lack of coordination between different departments, resulting in underutilization of resources and increased lead times.

4. **Lack of Data-driven Decision-making:** Decisions are often made based on intuition rather than data, leading to suboptimal production planning.

Solution: ABC Manufacturing decides to implement a comprehensive production management strategy to address these challenges.

1. **Process Redesign:** The company conducts a thorough analysis of its production processes and identifies bottlenecks. It redesigns the workflow to streamline processes, eliminate redundancies, and reduce waiting times.

2. **Quality Control Measures:** ABC Manufacturing implements a quality control system that includes rigorous testing and inspection at critical points in the production process. This helps identify and rectify defects early, reducing scrap and rework.

3. **Cross-functional Teams:** The company establishes cross-functional teams comprising representatives from different departments (production, procurement, logistics). These teams work together to ensure better coordination, resource allocation, and communication.

4. **Data Analytics and Forecasting:** ABC Manufacturing implements a data analytics system to gather real-time production data. This system helps predict demand, identify production trends, and make data-driven decisions for production planning.

5. **Training and Skill Development:** The company invests in training programs for its workforce to enhance their skills and improve overall productivity. This includes both technical training and soft skills development.

Results:

1. **Improved Efficiency:** The redesigned production processes lead to smoother workflows, reduced waiting times, and increased throughput.

2. **Enhanced Quality:** The implementation of quality control measures results in a significant reduction in defects, leading to lower scrap rates and improved product quality.

3. **Optimized Resource Allocation:** Cross-functional teams improve communication and collaboration between departments, leading to better resource utilization and reduced lead times.

4. **Data-driven Decision-making:** The use of data analytics enables more accurate demand forecasting, optimized inventory management, and better production planning.

5. **Higher Customer Satisfaction:** With improved efficiency and quality, ABC Manufacturing experiences higher levels of customer satisfaction and repeat business.

Conclusion: By implementing a comprehensive production management strategy that focuses on process optimization, quality control, cross-functional collaboration, data analytics, and skill development, ABC Manufacturing successfully overcomes its production challenges. The company not only improves its operational efficiency and quality standards but also strengthens its competitive position in the market and enhances customer satisfaction.

Case Study: Enhancing Productivity at XYZ Electronics

Background: XYZ Electronics is a medium-sized electronics manufacturing company that produces a range of consumer electronic devices. Over the past few years, the company has been experiencing challenges related to low productivity, high production costs, and inconsistent product quality. These issues are impacting its competitiveness and profitability.

Challenges:

1. **Low Efficiency:** Production processes are not optimized, leading to inefficiencies, delays, and extended lead times.

2. **High Costs:** The company is facing rising production costs due to wastage, inefficiencies, and overutilization of resources.

3. **Inconsistent Quality:** Defects and rework are common, affecting product quality and customer satisfaction.

4. **Lack of Innovation:** The company is struggling to introduce new products and adapt to market trends.

Solution: XYZ Electronics decides to embark on a comprehensive productivity improvement initiative to address these challenges.

1. **Process Reengineering:** The company conducts a thorough analysis of its production processes, identifies bottlenecks, and redesigns workflows. This streamlines operations and reduces waiting times.

2. **Lean Principles:** XYZ Electronics adopts lean manufacturing principles to eliminate waste and unnecessary steps from its processes. This includes implementing 5S practices, visual management, and value stream mapping.

3. **Quality Management System:** The company implements a robust quality management system, including regular inspections, quality control checkpoints, and employee training on quality standards.

4. **Technology Integration:** XYZ Electronics invests in automation and advanced manufacturing technologies to improve efficiency and reduce human errors. This includes the implementation of robotics and computerized systems.

5. **Employee Empowerment:** The company promotes a culture of continuous improvement and encourages employees to contribute ideas for enhancing productivity. Regular training programs are conducted to upskill the workforce.

6. **Innovation and R&D:** XYZ Electronics establishes a dedicated research and development (R&D) team to develop innovative products and stay ahead of market trends. This helps the company introduce new products faster.

Results:

1. **Increased Efficiency:** The process reengineering and lean practices lead to a significant increase in production efficiency. Waiting times are reduced, and production cycles are optimized.

2. **Cost Reduction:** The adoption of lean principles and technology integration results in reduced wastage, lower production costs, and improved resource utilization.

3. **Enhanced Quality:** The implementation of a rigorous quality management system leads to a substantial reduction in defects and rework, resulting in higher product quality.

4. **Faster Innovation:** The dedicated R&D team enables XYZ Electronics to introduce new products to the market more quickly, enhancing its competitiveness.

5. **Higher Productivity:** Overall, the company experiences a notable increase in productivity, with more products being produced in less time and at lower costs.

Conclusion: Through a combination of process reengineering, lean practices, quality management, technology integration, employee empowerment, and innovation, XYZ Electronics successfully improves its productivity and overcomes its operational challenges. The company not only achieves higher efficiency and quality but also enhances its ability to innovate and adapt to changing market demands, ultimately strengthening its position in the industry and improving its bottom line.

Case Study: Implementing TQM at ABC Auto Parts

Background: ABC Auto Parts is a medium-sized manufacturer of automotive components. The company was facing challenges related to inconsistent product quality, high defect rates, and declining customer satisfaction. In order to address these issues and enhance its competitiveness, ABC Auto Parts decided to adopt a Total Quality Management (TQM) approach.

Challenges:

1. **Inconsistent Quality:** The company's products were prone to defects and variations in quality, leading to frequent customer complaints.

2. **High Defect Rates:** The defect rates in the manufacturing process were leading to increased scrap and rework costs.

3. **Customer Dissatisfaction:** The inconsistent quality and frequent defects were affecting customer satisfaction and loyalty.

4. **Lack of Continuous Improvement:** The company lacked a structured approach to continuous improvement, hindering its ability to address root causes of quality issues.

TQM Implementation: ABC Auto Parts initiated a TQM initiative with the following key steps:

1. **Leadership Commitment:** Top management demonstrated a strong commitment to TQM, emphasizing the importance of quality and continuous improvement.

2. **Employee Training:** Employees at all levels received training in TQM principles, quality management concepts, and problem-solving techniques.

3. **Quality Circles:** Cross-functional quality circles were formed, comprising employees from different departments. These circles met regularly to discuss quality issues, identify root causes, and propose solutions.

4. **Process Redesign:** The company conducted a thorough analysis of its production processes, identified bottlenecks, and redesigned workflows to eliminate waste and improve efficiency.

5. **Statistical Process Control (SPC):** ABC Auto Parts implemented SPC techniques to monitor and control the manufacturing process, ensuring that variations were within acceptable limits.

6. **Supplier Collaboration:** The company collaborated closely with its suppliers, emphasizing the importance of quality standards and timely delivery of raw materials.

7. **Customer Feedback:** Customer feedback was actively collected and analyzed to identify areas for improvement and enhance customer satisfaction.

8. **Continuous Improvement:** The TQM approach fostered a culture of continuous improvement, where employees were encouraged to suggest and implement ideas for enhancing quality and efficiency.

Results:

1. **Improved Quality:** The implementation of TQM led to a significant reduction in defects and variations in product quality. The company's products became more consistent and reliable.

2. **Cost Savings:** With fewer defects and rework, the company experienced cost savings and reduced scrap expenses.

3. **Enhanced Customer Satisfaction:** The improved product quality resulted in higher customer satisfaction, leading to increased customer loyalty and repeat business.

4. **Efficiency Gains:** The process redesign and SPC techniques improved overall process efficiency, reducing lead times and production delays.

5. **Employee Engagement:** Employees were actively engaged in problem-solving and continuous improvement efforts, leading to a more motivated and empowered workforce.

Conclusion: By implementing Total Quality Management (TQM) principles, ABC Auto Parts successfully transformed its operations and overcame its quality-related challenges. The company's commitment to quality, employee involvement, process optimization, and continuous improvement resulted in improved product quality, increased customer satisfaction, and enhanced competitiveness in the automotive industry. TQM not only addressed immediate issues but also created a foundation for sustained excellence in quality and operations.

Certainly, here's a case study illustrating the successful implementation of quality circles within a manufacturing company:

Case Study: Quality Circles at XYZ Manufacturing

Background: XYZ Manufacturing is a large industrial equipment manufacturer facing challenges related to product defects, high levels of rework, and inefficient production processes. To address these issues and foster a culture of continuous improvement, the company decided to implement quality circles.

Challenges:

1. **High Defect Rates:** The company was experiencing frequent product defects, leading to increased scrap and rework costs.
2. **Inefficient Processes:** Production processes were not optimized, resulting in bottlenecks and longer lead times.
3. **Lack of Employee Involvement:** Employees were not actively involved in identifying and solving quality-related issues.

Quality Circle Implementation: XYZ Manufacturing introduced quality circles with the following steps:

1. **Formation of Quality Circles:** Cross-functional quality circles were formed, comprising employees from various departments, including production, engineering, and quality control.
2. **Training and Education:** Employees in the quality circles received training on quality management concepts, problem-solving techniques, and effective team collaboration.
3. **Identification of Issues:** Quality circle members were encouraged to identify and prioritize quality-related issues within their respective areas of expertise.
4. **Data Collection and Analysis:** The quality circles collected data on defects, production inefficiencies, and other quality-related metrics. They analyzed the data to identify root causes.
5. **Brainstorming and Solutions:** The quality circle members conducted brainstorming sessions to generate potential solutions for the identified issues.

6. **Implementation of Solutions:** Once solutions were agreed upon, the quality circle members implemented changes to the processes, workflows, and quality control measures.

7. **Regular Meetings:** Quality circles held regular meetings to discuss progress, share insights, and evaluate the impact of implemented solutions.

Results:

1. **Reduced Defects:** The implementation of quality circle initiatives led to a significant reduction in product defects, resulting in lower scrap and rework costs.

2. **Efficiency Improvements:** Quality circles identified and addressed inefficiencies in production processes, leading to streamlined workflows and reduced lead times.

3. **Employee Empowerment:** Employees in the quality circles felt empowered and engaged, as they actively contributed to problem-solving and process improvement.

4. **Cross-Functional Collaboration:** Quality circles promoted collaboration between different departments, facilitating a holistic approach to problem-solving.

5. **Continuous Improvement Culture:** The introduction of quality circles fostered a culture of continuous improvement throughout the organization.

Conclusion: By implementing quality circles, XYZ Manufacturing successfully addressed its quality-related challenges and improved overall production processes. The active involvement of employees in problem-solving, data analysis, and solution implementation resulted in reduced defects, enhanced efficiency, and a culture of continuous improvement. Quality circles not only led to immediate improvements but also contributed to a more engaged and empowered workforce, ultimately benefiting the company's competitiveness and long-term success

Case Study: ISO 9000 and ISO 14000 Implementation at GreenTech Electronics

Background: GreenTech Electronics is a medium-sized electronics manufacturing company that specializes in producing environmentally friendly consumer electronics. The company recognized the need to enhance its quality management and environmental practices to remain competitive and align with its sustainability goals. To achieve this, GreenTech Electronics decided to implement ISO 9000 and ISO 14000 standards.

Implementation Process:

ISO 9000 (Quality Management System):

1. **Assessment and Planning:** GreenTech Electronics conducted a thorough assessment of its existing quality management practices and identified areas for improvement. The management team established a clear plan for ISO 9000 implementation.

2. **Documentation:** The company developed comprehensive documentation outlining its quality management processes, procedures, and policies. This documentation provided a clear roadmap for employees to follow.

3. **Training and Awareness:** Employees received training on ISO 9000 standards, quality principles, and their roles in ensuring product quality. Awareness campaigns were conducted to emphasize the importance of quality throughout the organization.

4. **Implementation:** GreenTech Electronics implemented the documented quality management processes across all departments. Quality control checkpoints and inspections were introduced at various stages of production.

5. **Monitoring and Continuous Improvement:** The company established a system to monitor and measure key quality metrics, such as defect rates and customer complaints. Regular reviews and audits were conducted to identify areas for continuous improvement.

ISO 14000 (Environmental Management System):

1. **Environmental Assessment:** GreenTech Electronics conducted an environmental assessment to identify its significant environmental aspects and potential impacts. This assessment helped the company understand its environmental responsibilities.

2. **Development of EMS:** Based on the environmental assessment, the company developed an Environmental Management System (EMS). This system included policies, objectives, and action plans to minimize environmental impacts.

3. **Employee Training:** Employees were trained on the importance of environmental sustainability, waste reduction, and resource conservation. They were educated on how their roles contributed to the company's environmental goals.

4. **Implementation of EMS:** GreenTech Electronics integrated the EMS into its operations. Energy-efficient practices, waste reduction measures, and responsible sourcing of materials were implemented.

5. **Monitoring and Compliance:** The company closely monitored its environmental performance, tracking metrics such as energy consumption, waste generation, and emissions. Regular compliance checks ensured adherence to environmental regulations.

Results:

ISO 9000:

1. **Enhanced Product Quality:** The implementation of ISO 9000 led to improved product quality, fewer defects, and higher customer satisfaction.

2. **Streamlined Processes:** The structured quality management processes helped streamline production workflows and reduce errors.

3. **Cultural Shift:** Employees developed a culture of quality awareness, leading to greater attention to detail and proactive problem-solving.

ISO 14000:

1. **Reduced Environmental Impact:** The implementation of ISO 14000 resulted in reduced energy consumption, minimized waste generation, and lowered environmental impacts.

2. **Green Reputation:** GreenTech Electronics gained a reputation for environmental responsibility, attracting environmentally conscious customers.

3. **Compliance:** The company consistently met environmental regulations, avoiding penalties and legal issues.

Conclusion: By implementing ISO 9000 and ISO 14000 standards, GreenTech Electronics successfully improved its quality management practices, enhanced product quality, and demonstrated its commitment to environmental sustainability. These initiatives not only led to operational improvements but also positioned the company as a responsible and competitive player in the electronics manufacturing industry.

Case Study: Inventory Management Optimization at XYZ Retail

Background: XYZ Retail is a large chain of retail stores with multiple locations. The company was facing challenges in managing its inventory effectively, leading to stockouts, excess inventory, and increased carrying costs. To address these issues and improve overall inventory management, XYZ Retail decided to implement a comprehensive inventory management solution.

Challenges:

1. **Stockouts and Lost Sales:** Inadequate inventory levels were resulting in frequent stockouts, leading to lost sales and customer dissatisfaction.

2. **Excess Inventory:** Some stores were holding excess inventory, tying up capital and increasing carrying costs.

3. **Lack of Visibility:** The company lacked real-time visibility into inventory levels across its various locations, leading to inefficient replenishment decisions.

4. **Manual Processes:** Inventory management was primarily managed manually, leading to errors, inaccuracies, and delays in replenishment.

Inventory Management Solution:

1. **Technology Implementation:** XYZ Retail adopted an advanced inventory management software that provided real-time visibility into inventory levels, sales trends, and demand patterns across all locations.

2. **Demand Forecasting:** The company implemented demand forecasting models to predict future demand based on historical data, seasonal trends, and market conditions.

3. **Reorder Point Optimization:** Using the demand forecasts and lead time data, XYZ Retail established optimal reorder points to ensure timely replenishment without excess inventory.

4. **Safety Stock Levels:** Safety stock levels were calculated to account for demand variability and unexpected disruptions in the supply chain.

5. **ABC Analysis:** XYZ Retail categorized its inventory items using the ABC analysis, classifying items based on their value and criticality. This helped prioritize inventory management efforts.

6. **Supplier Collaboration:** The company collaborated closely with key suppliers to improve visibility into their production schedules, lead times, and delivery capabilities.

7. **Employee Training:** Store employees were trained on the new inventory management system and processes, emphasizing accurate data entry and timely replenishment.

Results:

1. **Reduced Stockouts:** With optimized reorder points and safety stock levels, XYZ Retail experienced a significant reduction in stockouts, leading to higher customer satisfaction and sales.

2. **Lower Carrying Costs:** Excess inventory was minimized, leading to lower carrying costs and improved capital utilization.

3. **Improved Replenishment:** Real-time visibility into inventory levels and demand patterns allowed the company to make informed replenishment decisions, reducing the need for emergency orders.

4. **Efficiency Gains:** The adoption of technology and automated processes streamlined inventory management, reducing manual errors and saving time.

5. **Data-Driven Decisions:** The company began making data-driven decisions based on accurate demand forecasts and inventory insights

Conclusion:

By implementing an advanced inventory management solution, XYZ Retail successfully optimized its inventory levels, reduced stockouts, and improved overall operational efficiency. The company's ability to make informed replenishment decisions based on accurate data and demand forecasts led to improved customer satisfaction, reduced carrying costs, and enhanced profitability. The case demonstrates the significance of adopting technology and data-driven approaches in effective inventory management.

Technology Implementation: XYZ Retail adopted an advanced inventory management software that provided real-time visibility into inventory levels, sales trends, and demand patterns across all locations.

1. **Demand Forecasting:** The company implemented demand forecasting models to predict future demand based on historical data, seasonal trends, and market conditions.

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5. **Supplier Collaboration:** The company collaborated closely with key suppliers to improve visibility into their production schedules, lead times, and delivery capabilities.

6. **Employee Training:** Store employees were trained on the new inventory management system and processes, emphasizing accurate data entry and timely replenishment.

Results:

1. **Reduced Stockouts:** With optimized reorder points and safety stock levels, XYZ Retail experienced a significant reduction in stockouts, leading to higher customer satisfaction and sales.

2. **Lower Carrying Costs:** Excess inventory was minimized, leading to lower carrying costs and improved capital utilization.

Improved Replenishment: Real-time visibility into inventory levels and demand patterns allowed the company to make informed replenishment decisions, reducing the need for emergency orders

2.12 QUESTIONS

Q.1Fill in the blanks :-

1) ________ is a measure of efficiency

   a) **productivity**   b) inventory   c) technology

2) The productivity movement in India started in________

   a)1957   b) 1947   c) **1966**

3) DSL is a ______ ratio

   a) **financial**   b) sales   c) cost

4) Tqm is a _________ ratio

   a) enhance   b) **strategic**   c) extensive

5) Quality circles are ___ group

   a) **smalll**   b) large   c) mass

True or False

1) The team uses MRP techniques to determine the quantity-true

2) In 1950 the green revolution boomed-false

3) Monitoring inventory level to avoid stock Out-true

4) Jit method helps in reducing insurance and storage cost - true 5) Developing production schedules ensures capacity planning- true

Match the column

A	B
1. Production management	a. Cost
2. Npc	b. Operation
3. IT	c. Labour
4. Inventory	d. BPO
5. Automation	e. 1958

Ans- 1-b 2-e 3- d 4-a 5- c

Answer in brief

1) what is the scope of production management ?

2) what are the types of inventory management?

3) Write key principles of tqm .

4) Write a note on

- productivity movement in India
- TQM
- ISO 9000 14000
- measures to increase productivity
- steps in planning

2.13 REFERENCES

1. **"Operations Management" by Jay Heizer and Barry Render:** This comprehensive textbook covers various aspects of operations management, including production planning, scheduling, inventory management, and quality control.

2. **"Production and Operations Analysis" by Steven Nahmias:** This book provides a detailed analysis of production and operations management concepts, with a focus on quantitative techniques and decision-making.

3. **"Introduction to Materials Management" by J.R. Tony Arnold, Stephen N. Chapman, and Lloyd M. Clive:** While primarily focused on materials management, this book offers insights into the broader aspects of production management, including inventory control and supply chain management.

4. **"Manufacturing Planning and Control for Supply Chain Management" by F. Robert Jacobs and William L. Berry:** This book covers manufacturing planning and control techniques, including production scheduling, capacity planning, and resource allocation.

5. **"Production and Operations Management" by S. Anil Kumar and N. Suresh:** A comprehensive textbook that covers various topics in production and operations management, including production systems, facility layout, and quality management.

6. **"Production Planning and Control" by Stephen A. Zaharuddin and Mohd Nizam Ab Rahman:** This book focuses on production planning and control techniques, providing insights into demand forecasting, scheduling, and capacity planning.

7. **"Operations Management" by Nigel Slack, Alistair Brandon-Jones, and Robert Johnston:** An in-depth textbook covering operations management principles, including production processes, capacity management, and lean production.

8. **"Modern Production/Operations Management" by Elwood S. Buffa and Rakesh K. Sarin:** This classic book explores production and operations management concepts, including process analysis, layout planning, and quality management.

9. **"Principles of Operations Management" by Jay Heizer and Barry Render:** Another valuable textbook by Heizer and Render, this book provides a comprehensive overview of operations and production management principles.

10. **"Operations Management: Sustainability and Supply Chain Management" by Jay Heizer, Barry Render, and Chuck Munson:** This book explores operations management in the context of sustainability and supply chain management, addressing contemporary challenges.

11. **"Handbook of Production Management Methods" by Andrew M. Sage and William B. Rouse:** A comprehensive reference book that covers a wide range of production management methods, techniques, and tools.

12. **"The Goal: A Process of Ongoing Improvement" by Eliyahu M. Goldratt:** While not a traditional production management textbook, this novel introduces the Theory of Constraints, which is a valuable concept in optimizing production processes.

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3

HUMAN RESOURCE MANAGEMENT - I

Unit Structure:

3.0 OBJECTIVE

On successful completion of the module students will be able to:

1. To develop an understanding of the functions of HRM.

2. To distinguish between Recruitment and Selection.

3. To relate the various stages in the Training cycle.

4. To develop an understanding of the basics of compensation management and Performance appraisal.

5. To discuss managing employee relations.

3.1 INTRODUCTION

Human Resource Management (HRM) is a strategic and integral function within organizations that focuses on the effective management of people to achieve organizational goals. It encompasses a wide range of activities related to the acquisition, development, utilization, and management of an organization's workforce. The primary objective of HRM is to maximize the performance and potential of employees in order to contribute to the overall success of the organization.

3.2 HUMAN RESOURCE MANAGEMENT

The term human resources was first used in the early 1900s, and then more widely in the 1960s, to describe the people who work for the organization, in aggregate. Human Resource Management is the process of recruiting, selecting, inducting employees, providing orientation, imparting training and development, appraising the performance of employees, deciding compensation and providing benefits, motivating employees, maintaining proper relations with employees and their trade unions, ensuring employees safety, welfare and health measures in compliance with labour laws of the land.

HRM is employee management with an emphasis on those employees as assets of the business. In this context, employees are sometimes referred to as human capital. As with other business assets, the goal is to make effective use of employees, reducing risk and maximizing return on investment.

HRM as a discipline has a few essential features. HRM is regarded as a subsystem of the organization.

3.3 NATURE/FEATURES OF HUMAN RESOURCE MANAGEMENT

1. Human Resource Management Is an Art and a Science.
2. Human Resource Management Is Pervasive
3. HRM is a Service Function
4. HRM is a Process
5. HRM is a Continuous Process
6. HRM must Be Regulation-Friendly.
7. HRM is An Interdisciplinary and Fast-Changing
8. Human Resource Management is Focused on Results.
9. Human Resource Management is People-Centered
10. Human Relations Philosophy
11. HRM is an Integrated Concept
12. HRM Develops Team Spirit

3.4 FUNCTIONS OF HRM

1. Job design and job analysis
2. Employee hiring and selection.
3. Employee training & development
4. Compensation and Benefits
5. Employee performance management

6. Managerial relations
7. Labour relations
8. Employee engagement & communication
9. Health and safety regulations
10. Personal support for employees
11. Succession Planning
12. Industrial Relations

1. **Job design and job analysis:** Job design involves the process of describing duties, responsibilities and operations of the job. To hire the right employees based on rationality and research, it is important to identify the traits of an ideal candidate who would be suitable for the job. This can be done by describing the skills and character traits of your top-performing employee. Doing so will help you determine the kind of candidate you want for the job. You will be able to identify your key minimum requirements in the candidate to qualify for the job.Job analysis involves describing the job requirements, such as skills, qualification and work experience. The vital day-to-day functions need to be identified and described in detail, as they will decide the future course of action while recruiting.

2. **Employee hiring and selection:** HRM aims to obtain and retain qualified and efficient employees to achieve the goals and objectives of the company. All this starts with **hiring the right employees** out of the list of applicants and favourable candidates.HRM helps to source and identify the ideal candidates for interview and selection. The candidates are then subjected to a comprehensive **screening process** to filter out the most suitable candidates from the pool of applicants. The screened candidates are then taken through different interview rounds to test and analyse their skills, knowledge and work experience required for the job position.

   Once the primary functions of HRM in recruitment are completed, and the candidate gets selected after rounds of interviews, they are then provided with the job offer in the respective job positions.

3. **Employee training & development**: Imparting proper training and ensuring the right development of the selected candidatesis a crucial function of HR. After all, the success of the organization depends on how well the employees are trained for the job and what are their growth and development opportunities within the organization.The role of HR should be to ensure that the new employees acquire the company-specific knowledge and skills to perform their task efficiently. It boosts the overall efficiency and productivity of the workforce, which ultimately results in better business for the company.

4. **Compensation and Benefits**: The role of human resource management is to formulate attractive yet efficient benefits and compensation packages to attract more employees into the workplace

without disturbing the finances of the company.The primary objective of the benefits and compensation is to establish equitable and fair remuneration for everyone. Therefore, one of the core HR department functions is to lay down clear policies and guidelines about employee compensation and their available benefits.

5. **Employee performance management:** Effective performance management ensures that the output of the employees meets the goals and objectives of the organization. Performance management doesn't just focus on the performance of the employee. It also focuses on the performance of the team, the department, and the organization as a whole.

6. **Managerial relations:** Relationships in employment are normally divided into two parts — managerial relations and labour relations. While labour relations is mainly about the relationship between the workforce and the company, managerial relations deals with the relationship between the various processes in an organization.It determine the amount of work that needs to be done in a given day and how to mobilise the workforce to accomplish the objective. It is about giving the appropriate project to the right group of employees to ensure efficient completion of the project. It is essential that HR handles such relations effectively to maintain the efficiency and productivity of the company.

7. **Labour relations:** Cordial labour relations are essential to maintain harmonious relationships between employees at the workplace. At the workplace, many employees work together towards a single objective. However, individually, everyone is different from the other in characteristics. Hence, it is natural to observe a communication gap between two employees. If left unattended, such behaviours can spoil labour relations in the company.Therefore, it is crucial for an HR to provide proper rules, regulations and policies about labour relations, so that every employee will be aware of the policies which will create a cordial and harmonious work environment.

8. **Employee engagement and communication: Employee engagement** is a crucial part of every organization. Higher levels of engagement guarantee better productivity and greater employee satisfaction. Efficiently managing employee engagement activities will help in improving the employee retention rates too. HRM is the right agent who can manage the employee engagement seamlessly. Proper communication and engagement will do wonders for the employees as well as the organization. The more engaged the employees are, the more committed and motivated they will be.

9. **Health and safety regulations:** Every employer should mandatorily follow the health and safety regulations laid out by the authorities. Our labour laws insist every employer provide whatever training, supplies, and essential information to ensure the safety and health of the employees. Integrating the health and safety regulations with company

procedures or culture is the right way to ensure the safety of the employees. Making these safety regulations part of company activities is one of the important functions of HRM.

10. **Personal support for employees :** HRM assists employees when they run into personal problems which may interfere with the workflow. Along with discharging administrative responsibilities, HR departments also help employees in need. Since the pandemic, the need for employee support and assistance has substantially increased. For example, many employees needed extra time off and medical assistance during the peak period of the pandemic. For those who reached out for help, whether it may be in the form of insurance assistance or extra leaves, companies provided help through HR teams.

11. **Succession Planning:** Succession planning is a core function of HRMs. It aims at planning, monitoring, and managing the growth path of the employees from within the organizations.What usually happens is that promising and bright employees within the organization who have excelled in their roles are handpicked by their supervisors and HRs, and their growth paths are developed.Succession planning helps identify the next person who is just right to replace the outgoing individual.However, while developing such employees towards a higher role, companies must keep in mind several aspects, such as improving employee engagement, assigning challenging tasks and activities.

12. **Industrial Relations:** For a company, especially into manufacturing and production, the HRs must have ongoing Industrial Relations practices. They must also continuously engage with the Unions in a friendly and positive manner to maintain amicable relations.The true motive of Industrial Relation touches on a lot of issues within the company. Industrial Relations may be in place to meet wage standards, reduce instances that call for strikes and protests, improve working and safety conditions for employees, reduce resource wastage and production time and so on.Industrial Relations is extremely important because, if handled properly, it can circumvent protests, violence, walkouts, lawsuits, loss of funds and production time. IR is a sensitive yet critical function of the HR department, naturally, it requires personnel with vast experience.

3.5 HUMAN RESOURCE PLANNING (HRP)

Human resources planning ensures the right type of people, in the right number, at the right time and place, who are trained and motivated to do the right kind of work at the right time, It determines the requirement of personnel as per organizational objectives. The ultimate aim of HRP is the **optimum allocation of a qualified workforce**.In HRP, the manager recruits human resources for present and future requirements.

Steps in Human Resource Planning :

Human resource planning is a process through which the right candidate for the right job is ensured. For conducting any process, the foremost essential task is to develop the organizational objective to be achieved through conducting the said process.

1. Analyzing Organizational Objectives: The objective to be achieved in future in various fields such as production, marketing, finance, expansion and sales gives the idea about the work to be done in the organization.

2. Inventory of Present Human Resources: From the updated human resource information storage system, the current number of employees, their capacity, performance and potential can be analyzed. To meet the various job requirements, the internal sources (i.e., employees from within the organization) and external sources (i.e., candidates from various placement agencies) can be estimated.

3. Forecasting Demand and Supply of Human Resource: The human resources required at different positions according to their job profile are to be estimated. The available internal and external sources to fulfill those requirements are also measured. There should be proper matching of job description and job specification of one particular work, and the profile of the person should be suitable to it.

4. Estimating Manpower Gaps: Comparison of human resource demand and human resource supply will provide with the surplus or deficit of human resource. Deficit represents the number of people employed, whereas surplus represents termination. Extensive use of proper training and development program can be done to upgrade the skills of employees.

5. Formulating the Human Resource Action Plan: The human resource plan depends on whether there is deficit or surplus in the organization. Accordingly, the plan may be finalized either for new recruitment, training, interdepartmental transfer in case of deficit of termination, or voluntary retirement schemes and redeployment in case of surplus.

6. Monitoring, Control and Feedback: It mainly involves implementation of the human resource action plan. Human resources are allocated according to the requirements, and inventories are updated over a period. The plan is monitored strictly to identify the deficiencies and remove them. Comparison between the human resource plan and its actual implementation is done to ensure the appropriate action and the availability of the required number of employees for various jobs.

3.6 HUMAN RESOURCE DEVELOPMENT

Human resource development includes training a person after he or she is first hired, providing opportunities to learn new skills, distributing resources that are beneficial for the employee's tasks, and any other developmental activities.

Human resource development in the organization context is a process by which the employees of an organization are helped, in a continuous and planned way to:

1. Acquire or sharpen capabilities required to perform various functions associated with their present or expected future roles.

2. Develop their general capabilities as individuals and discover and exploit their own inner potentials for their own and/or organizational development purposes; and

3. Develop an organizational culture in which supervisor-subordinate relationships, teamwork and collaboration among sub-units are strong and contribute to the professional wellbeing, motivation and pride of employees.

Methods of Training:

Management development is a systematic process of growth and development by which the managers develop their abilities to manage. It is concerned with not only improving the performance of managers but also giving them opportunities for growth and development.

There are two methods through which managers can improve their knowledge and skills. One is through formal training and other is through on the job experiences. The two methods are:

I: On-the-job Training Method

II: Off-the-Job Methods

On the job training is very important since real learning takes place only when one practices what they have studied.

But it is also equally important in gaining knowledge through classroom learning. Learning becomes fruitful only when theory is combined with practice. Therefore, on the job methods can be balanced with classroom training methods (off-the-job methods).

I.On-the-job training methods are as follows:

1. **Job rotation:**This training method involves the movement of a trainee from one job to another to gain knowledge and experience from different job assignments. This method helps the trainee understand the problems of other employees.

2. **Coaching:**Under this method, the trainee is placed under a particular supervisor who functions as a coach in training and provides feedback to the trainee. Sometimes the trainee may not get an opportunity to express his ideas.

3. **Job instructions:**Also known as step-by-step training in which the trainer explains the way of doing the jobs to the trainee and in case of mistakes, corrects the trainee.

4. **Committee assignments:**A group of trainees are asked to solve a given organizational problem by discussing the problem. This helps to improve teamwork.

5. **Internship training:** Under this method, instructions through theoretical and practical aspects are provided to the trainees. Usually, students from the engineering and commerce colleges receive this type of training for a small stipend.

II: Off-the-job Methods are as follows:

1. **Case study method:**Usually case study deals with any problem confronted by a business which can be solved by an employee. The trainee is given an opportunity to analyse the case and come out with all possible solutions. This method can enhance analytic and critical thinking of an employee.

2. **Incident method:**Incidents are prepared on the basis of actual situations which happened in different organizations and each employee in the training group is asked to make decisions as if it is a real-life situation. Later on, the entire group discusses the incident and takes decisions related to the incident on the basis of individual and group decisions.

3. **Role play:**In this case also a problem situation is simulated by asking the employee to assume the role of a particular person in the situation. The participant interacts with other participants assuming different roles. The whole play will be recorded, and trainees get an opportunity to examine their own performance.

4. **In-basket method:**The employees are given information about an imaginary company, its activities and products, HR employed, and all data related to the firm. The trainee (employee under training) has to make notes, delegate tasks and prepare schedules within a specified time. This can develop situational judgments and quick decision-making skills of employees.

5. **Business games:**According to this method the trainees are divided into groups and each group has to discuss various activities and functions of an imaginary organization. They will discuss and decide about various subjects like production, promotion, pricing etc. This results in co-operative decision-making process.

6. **Grid training:**It is a continuous and phased program lasting for six years. It includes phases of planning development, implementation and evaluation. The grid takes into consideration parameters like concern for people and concern for people.

7. **Lectures:**This will be a suitable method when the numbers of trainees are quite large. Lectures can be very helpful in explaining the concepts and principles very clearly, and face to face interaction is very much possible.

8. **Simulation:** Under this method an imaginary situation is created, and trainees are asked to act on it. For e.g., assuming the role of a marketing manager solving the marketing problems or creating a new strategy etc.

9. **Management education:**At present universities and management institutes give great emphasis to management education. For e.g., Mumbai University has started bachelors and postgraduate degree in Management. Many management Institutes provide not only degrees but also hands on experience having collaboration with business concerns.

10. **Conferences:**A meeting of several people to discuss any subject is called a conference. Each participant contributes by analyzing and discussing various issues related to the topic. Everyone can express their own viewpoint.

3.7 PERFORMANCE APPRAISAL

Performance appraisal is a process for evaluating and documenting how well an employee is carrying out his or her job. It is part of a company's performance management system. Performance appraisals are based on the employee's progress against goals set once a year with his or her manager.

A performance appraisal used in the organization is a regular review of employees' performance to verify their contribution to the company. It is also known as an annual review or performance evaluation. It evaluates the skills, growth, achievement, or failure of the employees. The performance appraisal is often used to justify the decisions related to promotions, pay hikes, bonuses, and **termination of the employee.**

Performance Appraisal definitions:

Edwin B. Flippo "Performance appraisal is a systematic, periodic and so far as humanly possible, an impartial rating of an employee's excellence in matters pertaining to his present **job** and to his potentialities for a better job."

Gomej-Mejia "Performance Appraisal involves the identification, measurement and management of human performance in organisation."

Slabbert and Swanepoel "Performance appraisal is a formal and systematic process by means of which the relevant strengths and weaknesses of the employees are identified, measured, recorded and developed."

Methods of Performance Appraisal

Employee performance appraisal has two types of methods namely traditional methods and modern methods used by various organizations. The traditional methods are quite simple and quick to execute while the modern methods are more focused on covering the overall well-being of the organization.

Traditional Methods of Employee Performance Appraisal

- **Rating Scales:** In this scale, factors such as attitude, initiative, dependability, etc are quantified. A range of excellent to poor is provided to the rater and based on the rating the performance of the employee is calculated.

- **Checklist:** A checklist form of performance appraisal consist of a column of 'Yes' and 'No' for different employee traits. The rater has to put a tick mark based on if the traits exist or do not exist in the employee.

- **Forced Choice Method**: In this method, different statements about the performance of the employee are provided to the rater and he/she is forced to answer the ready-made statements as true or false. Further evaluation of performance is carried on by the **Human Resource** department based on the answers of the rater.

- **Forced Distribution Method**: In this method, it is assumed that the performance of an employee conforms to a **bell-shaped curve**. Thus, the rater has to put employees on provided points on the scale.

- **Critical Incidents Method**: Here the critical behavior of the employee is considered by the supervisor while evaluating the performance.

- **Behaviorally Anchored Rating Scale**: Different statements which are descriptive in nature are prepared about the behavior of the employee. These behaviors are put on the scale points and the rater has to indicate the points which explain the employee behavior in a more exact way.

- **Field Review Method**: In this method, the reviewer of the performance is generally someone outside the department. The people from the HR department or corporate office do the performance evaluation of the employee based on the records and interviews.

- **Performance Tests and Observations**: This is a kind of oral test that is conducted to test the skills and knowledge of the employees in their respective fields. The employees sometimes receive a situation and are asked to demonstrate their skills and then their performance is evaluated based on that presentation.

- **Confidential Reports**: Often the government departments follow this method of performance evaluation. The employees are evaluated based on the parameters such as leadership quality, teamwork, integrity, technical ability, attendance, etc. The reviewer sends a confidential review to the concerned authority about the performance of the employee.

- **Essay Method:** Under this method, the detailed description of the employee performance is written by the rater. The performance of an employee, his relations with other Co-workers, requirements of training and development programs, strengths and weaknesses of the employee etc. are some of the points that are included in the essay. The efficiency of this traditional method of performance appraisal depends on the writing skills of the rater.

- **Cost Accounting Method**: It is a simple method in which the performance of the employee is linked with the monetary benefits of the organization. The rater checks about the cost to the company to keep the employee and the contribution of the employee in terms of monetary business.

- **Comparative Evaluation Approaches**: This approach includes a comparison of the performance of co-workers with each other. It is of two types namely the ranking method and paired comparison method. It is a quite popular method of employee performance appraisal in the corporate world.

Modern Methods of Employee Performance Appraisal

- **Management by Objectives**: In this method, the performance of the employee is assessed based on the targets achieved by him/her. The management at the beginning of the financial year conveys the set goals to the employees, at the end of the year the performance of the employee is compared with the set goals and evaluated for the appraisal.

- **Psychological Appraisals**: Psychologists are invited to the companies for the performance appraisal of the employees. Here the performance is in the context of the potential future performance. Psychological tests, in-depth interviews, reviews, and discussions with the managers are the methods used for the evaluation of the performance.

- **Assessment Centers**: A series of exercises are conducted at the assessment center of the company to actually evaluate the performance of the employee. The exercises include discussions, role-playing, computer simulations, and many more. The employees are evaluated in terms of communication skills, mental alertness, emotional intelligence, confidence, and administrative abilities. The rater observes the event and evaluates the performance of the employee at the end.

- **360-Degree Feedback**: It is particularly a **360-degree feedback** method in which the information about the performance of the employee is collected from supervisors, peers, group members, and self-assessment. All the remarks are considered to evaluate the overall work performance of the employee.

3.8 EMPLOYEE RETENTION

Employee retention is the organizational goal of keeping productive and talented workers and reducing turnover by fostering a positive work atmosphere to promote engagement, showing appreciation to employees, providing competitive pay and benefits, and encouraging a healthy work-life balance.

Employee retention is defined as an organization's ability to prevent employee turnover, or the number of people who leave their job in a certain period, either voluntarily or involuntarily. Increasing employee retention has a direct impact on business performance and success.

Benefits of Employee Retention

As businesses compete for top talent, employee retention is crucial. While some experts suggest that a 90% retention rate is a good goal, the reality is, it varies across different companies and industries. However, the ability to retain employees is universally beneficial for many reasons.

1. **Cost reduction.** U.S. employers spend hundreds of millions of dollars every year recruiting and training new workers. Those costs are sunk if an employee leaves prematurely. Productivity, team cohesiveness and morale also take a hit — which also has a financial impact. Total replacement costs for each employee can range from 90% of a worker's salary for an entry-level employee to 200% or more for tenured professionals and leaders.

2. **Recruitment and training efficiency.** By focusing on employee retention, companies reduce recruiting costs and enjoy greater returns on employee training. Recruiting costs include fees paid to recruiters or to advertise the position, interview-related travel and possible signing bonuses. Next comes training, which can also be costly. If the employee leaves prematurely after being hired, that money is wasted.

3. **Increased productivity.** Employee turnover sets back productivity because it takes time for a new worker to get up to speed and produce at a comparable level as their predecessor. It also takes a toll on remaining staff, who have to take on additional work and may produce lower-quality output as a result. Conversely, high-retention workplaces tend to have more engaged workers who, as a result, are more productive.

4. **Improved employee morale.** Organizations with successful employee retention programs foster greater connectedness and engagement, which helps morale and, in turn, boosts retention. Conversely, a steady stream of departures has a dampening effect on workplace morale, with side effects that include a decrease in work quality and more workers who decide to leave.

5. **Experienced employees.** It stands to reason that the longer employees remain at an organization, the more engaged, knowledgeable and skillful they are. They have also forged valuable relationships with customers and co-workers. When an employee departs, the company incurs an opportunity cost in the potential value the employee could have delivered.

6. **Better customer experience.** Inexperienced and less adept new hires may be more prone to missteps that negatively impact a customer's experience with the company. Satisfied, longer-term employees are often more skilled in dealing with customers and may have strong relationships with them. This is as true during all the stages leading to a signed contract as it is post-sales, when a customer might reach out to customer service. A better customer experience can also be a key brand differentiator.

7. **Improved employee satisfaction and experience.** A symbiotic relationship exists between retention and both employee satisfaction — worker happiness and fulfillment — and employee engagement, the level of commitment workers bring to their roles. Satisfied and engaged employees are often more likely to stay in an organization, and organizations with high retention rates often experience greater employee satisfaction and engagement.

8. **Stronger corporate culture.** Corporate culture develops over time, based on employees' cumulative traits and interactions. When engaged employees who are aligned with an organization's culture stay, they strengthen the organizational ethos. A strong corporate culture also improves productivity and performance.

9. **Increased revenue.** Employee retention is not just about cutting costs; anecdotal evidence shows it can have a positive impact on revenue as well. Employers with better retention rates deliver a better customer and employee experience, hold on to experienced top talent and are more productive — each of which can boost growth.

3.9 SUMMARY

HRM is a multifaceted function that plays a critical role in managing an organization's most valuable asset—its people. By aligning HR practices with organizational goals and fostering a positive work environment, HRM contributes to the overall success and sustainability of the organization.

3.10 QUESTIONS

Que:1 Human resource management emphasisa. Development of people

b. Punishment of people

c. Adoption of people

d. None of these

Ans: a

Que:2 Human resource management is amalgam ofa. Job analysis, recruitment and selection

b. Social behaviour and business ethics

c. Organisational behaviour, personal management and industrial relation

d. Employer and employees

Ans: c

Que: 3 Training process is

a. Short term

b. Medium term

c. Long term

d. None of these

Ans: a

Que: 4 OJT stands for

a. On the job training

b. On the job technique

c. On the job technology

d. Off the job training

Ans: a

Que:5 On the job training includes

a. Coaching

b. Conference

c. Understudy

d. All of these

Ans: d

Que:6 Relative worth of a job is known by

a. Job design

b. Job analysis

c. Job evaluation

d. Job change

Ans: c

Que: 7 Methods of job evaluation are

a. Qualitative method

b. Quantitative method

c. Both (a) and (b)

d. None of these

Ans: c

Que: 8 ------- is the systematic, periodic and impartial rating of an employee excellence in matters pertaining to his present job and his potential for a better job.

a. Performance appraisal

b. Compensation and motivation

c. Training and Development

d. Performance indicator

Ans: a

Que: 9 Traditional method of performance appraisal includes

a. Confidential reports

b. Paired comparison method

c. Free form or easy method

d. All of these

Ans: d

Que: 10 Modern method of performance appraisal are:

a. Assessment centre method

b. Management by objectives

c. BARS (Behaviourally anchored rating scale)

d. All of these

Ans: d

4

HUMAN RESOURCE MANAGEMENT - II

Unit Structure:

4.0 OBJECTIVE

On successful completion of the module students will be able to learn and demonstrate a range of competencies and skills including:

1. Leadership competencies
2. Motivation strategies
3. Team Building and Management
4. Decision making skills
5. Conflict resolution
6. Self-awareness and emotional intelligence

4.1 INTRODUCTION

Studying leadership and motivation strategies can provide individuals with a range of valuable skills and insights that are applicable in various personal and professional contexts. Leadership and motivation are integral components in the realm of management and organizational behavior. Both play pivotal roles in influencing individuals and teams to achieve common goals and maximize performance. Let's delve into an introduction to these crucial concepts:

4.2 LEADERSHIP TRAITS

Leadership traits are the people management skills, personal qualities and technical expertise a person requires to lead effectively in the workplace.

1. **Integrity**: Integrity is an essential leadership trait for the individual and the organization. It's especially important for top-level executives who are charting the organization's course and making countless other significant decisions. Our research has found that integrity may actually be a potential blind spot for organizations, so make sure your organization reinforces the importance of honesty and integrity to leaders at various levels.

2. **Delegation:** Delegating is one of the core responsibilities of a leader, but it can be tricky to delegate effectively. The goal isn't just to free yourself up — it's also to enable your direct reports to grow, facilitate teamwork, provide autonomy, and lead to better decision-making. The best leaders build trust in the workplace and on their teams through effective delegation.

3. **Communication:**Effective leadership and effective communication are intertwined. The best leaders are skilled communicators who are able to communicate in a variety of ways, from transmitting information to inspiring others to coaching direct reports. And you must be able to listen to, and communicate with, a wide range of people across roles, geographies, social identities, and more. The quality and effectiveness of communication among leaders across your organization directly affects the success of your business strategy, too.

4. **Self-Awareness:** While this is a more inwardly focused trait, self-awareness and humility are paramount for leadership. The better you understand yourself and recognize your own strengths and weaknesses, the more effective you can be as a leader. Do you know how other people view you or how you show up at work? Take the time to learn about the 4 aspects of self-awareness and how to strengthen each component.

5. **Gratitude:** Being thankful can lead to higher self-esteem, reduced depression and anxiety, and better sleep. Gratitude can even make you a better leader. Yet few people regularly say "thank you" in work settings, even though most people say they'd be willing to work harder for an appreciative boss. The best leaders know how to show gratitude in the workplace.

6. **Learning Agility:** Learning agility is the ability to know what to do when you don't know what to do. If you're a "quick study" or are able to excel in unfamiliar circumstances, you might already be learning agile. But anybody can foster and increase learning agility through practice, experience, and effort. After all, great leaders are really great learners.

7. **Influence:** For some people, "influence" feels like a dirty word. But being able to convince people through the influencing tactics of logical, emotional, or cooperative appeals is an important trait of inspiring, effective leaders. Influence is quite different from manipulation, and it needs to be done authentically and transparently. It requires emotional intelligence and trust.

8. **Empathy :** Empathy is correlated with job performance and is a critical part of emotional intelligence and leadership effectiveness. If you show more inclusive leadership and empathetic behaviors toward your direct reports, our research shows you're more likely to be viewed as a better performer by your boss. Plus, empathy and inclusion are imperatives for improving workplace conditions for those around you.

9. **Courage :** It can be hard to speak up at work, whether you want to voice a new idea, provide feedback to a direct report, or flag a concern for someone above you. That's part of the reason courage is a key trait of good leaders. Rather than avoiding problems or allowing conflicts to fester, having courage enables leaders to step up and move things in the right direction. A workplace with high levels of psychological safety and strong conversational skills across the organization will foster a coaching culture that supports courage and truth-telling.

10. **Respect :** Treating people with respect on a daily basis is one of the most important things a leader can do. It will ease tensions and conflict, create trust, and improve effectiveness. Creating a culture of respect is about more than the absence of disrespect. Respectfulness can be shown in many different ways, but it often starts with simply being a good listener who truly seeks to understand the perspectives of others.

Even the strongest leaders need dedicated teams to complete projects. To be an effective leader, you must know how to encourage teamwork and collaboration, inspire team members to contribute their best work and motivate colleagues to accomplish seemingly impossible tasks.

4.3 STYLES OF LEADERSHIP

1. **Authoritarian or autocratic leadership style**

Authoritarian—also referred to as autocratic—leaders have clear command and control over their peers. Decision-making is centralized, meaning there is one person making the critical decisions. An authoritarian leader has a clear vision of the bigger picture, but only involves the rest of the team on a task-by-task or as-needed basis.

Authoritarian leaders will be personal when giving others praise or criticism but clearly separate themselves from the group. While you might assume an authoritarian leader would be unpleasant, this isn't typically true. Rarely are they openly hostile. Instead, they're typically friendly or, at times, impersonal.

2. Participative leadership style

Participative or democratic leaders welcome everyone's opinions and encourage collaboration. While they might have the final say, these leaders distribute the responsibility of making decisions to everyone.

Participative leaders are part of the team. They invest their time and energy in their colleagues' growth because they know it will, in turn, help them reach the end goal. If you excel in collaborative group environments, this might be your leadership style.

3. Delegative or laissez-faire leadership style

Lewin's third style is delegative or laissez-faire leadership. Delegative leaders offer very little guidance to the group. They allow team members complete freedom in the decision-making process.

Delegative leaders separate themselves from the group and choose not to participate or interrupt the current trajectory of a project. Their comments are infrequent. Group members might even forget what this leader looks like by the time they finish the project.

4. Visionary leadership style

Visionary leadership is comparable to Lewin's authoritative leadership style. Visionary leaders have clear, long-term visions, and are able to inspire and motivate others.

his type of leadership is best used when there is a big change in the company or a clear direction is needed. In this case, people are looking for someone they trust to follow into the unknown.

It is less successful when other team members are experts who have differing ideas or opinions than that of the leader. These team members won't want to blindly follow a leader they don't agree with.

5. Coaching leadership style

A coaching leader is able to identify other team members' strengths and weaknesses and coach them to improve. They are also able to tie these skills to the company's goals.

Coaching leadership is successful when the leader is creative, willing to collaborate, and can give concrete feedback. It's also important that the coach knows when to step back and give the person autonomy.

If you've ever had a bad coach, you know that coaching isn't for everyone. When done poorly, coaching leadership can be seen as micromanaging.

6. Affiliative leadership style

Affiliative leadership is relationship focused. The intention of an affiliative leader is to create harmony. This charismatic leader works to build and foster relationships within the workplace which leads to a more collaborative and positive work environment.

An affiliative leader is helpful when creating a new team or when in crisis, as both of these situations require trust. This leadership style can be harmful when the leader focuses too much on being a friend and is less concerned with productivity and company goals.

4.4 MOTIVATION

Motivation is a psychological process through which a person acts or behaves towards a particular task or activity from start to completion. Motivation drives or pushes a person to behave in a particular way at that point in time.

Factors Influencing Motivation

Keeping employees motivated is the biggest challenge for companies to ensure that they give a high productive output at work and help in achieving company goals. A positive motivation amongst employees helps drive the business positively & enhances creativity.

Explanation of the factors influencing motivation

1. **Salary**: Monetary compensation & benefits like gross salary, perks, performance bonuses etc. are the biggest motivation factors. The better the salary and monetary benefits, the higher is the motivation level & passion of a person towards a job.

2. **Recognition:** Rewards, recognition, accolades etc. are important for ensuring high enthusiasm levels for an employee. If the hard work of an individual is appreciated, it keeps them motivated to perform better.

3. **Work Ethics:** Ethical working environment, honesty etc. are important factors for any individual. Good work ethics in a company helps keep employees motivated at work place.

4. **Transparency with Leadership**: The leadership in an organization helps in employee motivation if there are transparent discussion and flatter hierarchies. Senior management must ensure that all subordinates are happy, focused & motivated.

5. **Culture at Work:** A good, vibrant, positive culture at the workplace is always an important factor.People from different backgrounds, religions, countries etc. working together helps create a social bond at workplace.

6. **Learning and Development:** Another factor influencing is the training and development opportunities that a person gets. L&D helps individuals develop more skills and have better opportunities in their professional career.

7. **Work Life Balance:** Having a good quality of work life (QWL) helps in the motivation of people. A good work life balance ensures that a person can give quality time to both office work as well as family.

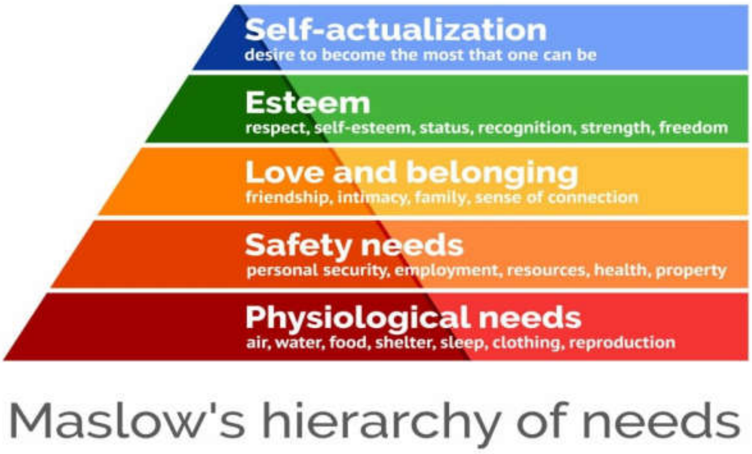
8. **Career Growth Opportunities:** Career development opportunities have a positive influence on the motivation of any person. If a person knows their future & career path is secure, they tend to work with more passion.

9. **Health Benefits:** Health benefits, insurance & other incentives act as a source of motivation for people. If the medical bills, hospitalization charges etc. are taken care of by the company, it helps build a strong trust.

10. **Communication:** positive& transparent communication between managers and subordinates gives a sense of belonging and adds to the employee's motivation. Discussion related to work as well as personal life helps make a friendly bond at workplace.

4.5 MASLOW'S HIERARCHY OF NEEDS THEORY OF MOTIVATION

Abraham Maslow's hierarchy of needs is one of the best-known theories of motivation. Maslow's theory states that our actions are motivated by certain physiological and psychological needs that progress from basic to complex.



The main goal of this need hierarchy theory is to attain the highest position or the last of the needs, i.e. need for self-actualization.

Levels of Hierarchy

The levels of hierarchy in Maslow's need hierarchy theory appear in the shape of a pyramid, where the most basic need is placed at the bottom while the most advanced level of hierarchy is at the top of the pyramid.Maslow was of the view that a person can only move to the subsequent level only after fulfilling the needs of the current level. The needs at the bottom of the pyramid are those which are very basic, and the most complex needs are placed on the top of the pyramid.

1. **Physiological needs:** The physiological needs are regarded as the most basic of the needs that humans have. These are needs that are very crucial for our survival. The examples of physiological needs are food, shelter, warmth, health, homeostasis and water, etc.

2. **Safety Needs:** Once the basic needs of food, shelter, clothing, etc. are fulfilled, there is an innate desire to move to the next level. The next level is known as the safety needs. Here the primary concern of the individual is related to safety and security.Safety and security can be regarding many things like a stable source of income that provides financial security, personal security from any kind of unnatural events, attacks by animals and emotional security and physical safety which is safety to health.

3. **Social Needs (Also known as Belonging Needs):** It is that stage where an individual having fulfilled his physiological needs as well as safety needs seeks acceptance from others in the form of love, belongingness. In this stage, human behavior is driven by emotions and the need for making emotional relationships is dominant here for e.g. friendship, family, intimacy, social group etc.

4. **Esteem needs:** It is related to the need of a person being recognized in the society. It deals with getting recognition, self-respect in the society. The need for recognition and acceptance arises when a person

has fulfilled their need for love and belongingness.In addition to recognition from others, there is a need for the person to develop self-esteem and personal worth.

5. **Self-actualization needs:** This is the final level of the theory of hierarchy of needs as proposed by Maslow. It is the highest level of needs and is known as the self-actualization needs. It relates to the need of an individual to attain or realize the full potential of their ability or potential.At this stage, all individuals try to become the best version of themselves. It is the journey of personal growth and development.

4.6 DOUGLAS MCGREGOR'S THEORY X AND THEORY Y

The concept of Theory X and Theory Y was developed by social psychologist Douglas McGregor. It describes two contrasting sets of **assumptions** that managers make about their people: Theory X – people dislike work, have little ambition, and are unwilling to take responsibility.

Theory X

According to McGregor, Theory X management assumes the following:

- Work is inherently distasteful to most people, and they will attempt to avoid work whenever possible.
- Most people are not ambitious, have little desire for responsibility, and prefer to be directed.
- Most people have little aptitude for creativity in solving organizational problems.
- Motivation occurs only at the physiological and security levels of Maslow's hierarchy of needs.
- Most people are self-centered. As a result, they must be closely controlled and often coerced to achieve organizational objectives.
- Most people resist change.
- Most people are gullible and unintelligent.

Essentially, Theory X assumes that the primary source of employee motivation is monetary, with security as a strong second. Under Theory X, one can take a hard or soft approach to getting results.

Theory Y

The higher-level needs of esteem and self-actualization are ongoing needs that, for most people, are never completely satisfied. As such, it is these higher-level needs through which employees can best be motivated.In strong contrast to Theory X, Theory Y management makes the following assumptions:

- Work can be as natural as play if the conditions are favorable.
- People will be self-directed and creative to meet their work and organizational objectives if they are committed to them.
- People will be committed to their quality and productivity objectives if rewards are in place that address higher needs such as self-fulfillment.
- The capacity for creativity spreads throughout organizations.
- Most people can handle responsibility because creativity and ingenuity are common in the population.
- Under these conditions, people will seek responsibility.

Under these assumptions, there is an opportunity to align personal goals with organizational goals by using the employee's own need for fulfillment as the motivator. McGregor stressed that Theory Y management does not imply a soft approach.

McGregor recognized that some people may not have reached the level of maturity assumed by Theory Y and may initially need tighter controls that can be relaxed as the employee develops.

4.7 HRM CASE STUDY 1

Sumit and Hardik both of them are postgraduates in management under different streams from the same B-School. Both of them are close to each other from the college days itself and the same friendship continues in the organization too as they are placed in the same company, Hy-tech technology solutions. Sumit placed in the HR department as employee counsellor and Hartik in the finance department as a key finance executive. As per the grade is concerned both are at the same level but when responsibility is concerned Ratik is holding more responsibility being in core finance.

By nature, Sumit is friendly in nature and ready to help the needy. Hardik is silent in nature ready to help if approached personally and always a bit egoistic in nature. They have successfully completed 4 years in the organization. And management is very much satisfied with both of them as they are equally talented and constant performers.

Sumit felt that now a day's Hardik is not like as he uses to be in the past. He noticed some behavioral changes with him. During general conversations, he feels that Hardik is taunting him that he is famous among the employees in the organization, on the other hand, he is not even recognized by fellow employees.

One morning Mr. Mehta General Manager Hy-tech technology solutions shocked while going through the mail received from Hardik about his resignation. Mr. Mehta called Sumit immediately and discussed the same as he is close to Hardik.On hearing the news Sumit got stunned and said that he does not know this before he also revealed his current experience with him. Mr. Mehta who does not want to lose both of them promised him that he will handle this and he won't allow Hardik to resign.

In the afternoon Mr. Metha took Hardik to the Canteen to make him comfortable after some general discussion he starts on the issue. Hardik, after some hesitation, opened his thinking in front of Mr. Mehta. The problem of Hardik is

1) when he comes alone to the canteen the people from others don't even recognize him but if he is accompanied by Sumit he gets well treated by others.

2) one day Both of them entered the company together the security in the gate wished them but the next day when he came alone the same security did not do so.

3) Even in meetings held in the office, the points raised by Sumit will get more value so many times he keeps silent in the meeting.

Questions for HRM Case Studies: Case Study 1

Find the reason that Mr. Mehta would have given to Hardik.

Solution for HRM Case Study 1

Mr. Mehta listening to this case understood the situation and realized the reason behind the partial response given by the employees towards Franklin and Harsha. As Franklin said both Harsha and Franklin are passed out from the same college in the same year. Both of them joined the company together both have the same experience. Even in performance-wise, both stands in the same level i.e. both are constant performers and good performers.

Franklin analyzed all the above-said similarities between him and Harsha. He also stated that he holds more responsibility than that of Harsha. One thing Franklin did not notice or analyzed is the job profile of Harsha. It is true that Franklin holds more responsibility than that of Harsha but when it comes to direct interaction with employees Harsha wins the employees' attention in this aspect. Harsha being a counsellor in HR she faces the employees every day. She developed good rapport among the employees due to her friendly nature. She is always remembered by the employees whenever they face any problem as she gives good counselling and most of the time she suggests the best solutions for such issues.

Franklin though holding a key position in finance his profile does not allow him to interact with the employees. Though he has a helping tendency he does only when someone approached him personally. As the employees of other departments do not have any relation with him they never approach him for help. Mr. Mehta having a good experience understood these things when Franklin explained his problems one by one.

Later he relates each situation, explained by Franklin with the above said reasons and made Franklin understood the reality.

Mr. Mehta said that the security in the gate or the employees in the canteen who recognized Harsha and not Franklin would have interacted with her during counselling or approached her for any issues. And as usual, she would have counselled well or solved the issues of them that is the reason why they treat her and wish her whenever where ever they meet her. When it comes to the case of Franklin they would have hardly met him or interacted with him.

When it comes to the point that even in-office meetings Harsha, points are valued so Franklin keeps mum. For this, Mr. Mehta replied that the points put forward by her would be related to employees or from the employees' point of view which actually the management wants to know so they give value to her points. And as quoted Fraklin after, one or two such incidents keep silent in the meeting. He never made an attempt to raise some suggestions so management does not have any option to listen to that suggestion.

After listening to all the explanations given by Mr. Mehta Franklin realized his mistake and felt proud of the Rapport developed by Harsha among the employees. He said to Mr. Mehta that he will take back his resignation. And rushed to Harsha to make an apology and to meet her as a friend as like his college days.

HRM Case Study 2

Watson Public Ltd Company is well known for its welfare activities and employee-oriented schemes in the manufacturing industry for more than ten decades. The company employs more than 800 workers and 150 administrative staff and 80 management-level employees. The Top-level management views all the employees at the same level. This can be clearly understood by seeing the uniform of the company which is the Same for all starting from MD to floor level workers. The company has 2 different cafeterias at different places one near the plant for workers and others near the Administration building. Though the place is different the amenities, infrastructure and the food provided are of the same quality. In short, the company stands by the rule of **Employee Equality.**

The company has one registered trade union. The relationship between the union and the management is very cordial. The company has not lost a single man day due to strike. The company is not a paymaster in that industry. The compensation policy of that company, when compared to other similar companies, is very less still the employees don't have many grievances due to the other benefits provided by the company. But the company is facing a countable number of problems in supplying the materials in the recent past days. Problems like quality issues, mismatch in packing materials (placing material A in the box of material B) incorrect labelling of material, not dispatching the material on time, etc…

The management views the case as there are loopholes in the system of various departments and hand over the responsibility to the HR department to solve the issue. When the HR manager goes through the issues he realized that the issues are not relating to the system but it relates to the employees. When investigated he come to know that the reason behind the casual approach by employees in work is

- The company hired new employees for a higher-level post without considering the potential internal candidates.
- The newly hired employees are placed with higher packages than that of existing employees in the same cadre.

Questions:

1. Narrate the case with a suitable title for the case. Justify your title.

Solution for HRM Case Case Study 2

Employee Equality is not the need for every hour. In the above-said case, Watson Ltd had provided all facilities to employees at each grade in an equal manner. But still, the employees started creating certain issues like materials are meeting the quality supply schedule is not met etc. And the HR manager said that the policy of hiring new employees for the higher post without considering old potential employees is the major problem.

"Employee recognition VS Employee equality". As the HR manager states that employees are not been recognized for the potential rather the company has gone for new recruitment. Because of which the company faces problems.

2. The points rose by the HR manager as the reason for the latest issues in the organization is justifiable or not. Support your answer with Human resource related concepts.

Yes, the points raised by the HR manager is justifiable because "Human beings are social Animals as popularly" said by many Human resources Scholars. So human minds demand social recognition, self-respect, consideration, etc for their work and performance.

In the above-said case, even the company provides and stands by the concept of employee equality when it fails to recognize the potential talents of existing employee they felt dissatisfaction towards the organization and they showed in the way of quality issues and slow down production.

4.8 SUMMARY

Studying leadership and motivation strategies is not only about theoretical knowledge but also about practical application. The application of these skills can lead to improved leadership effectiveness, increased team satisfaction and productivity, and overall success in various professional and personal endeavors.

4.9 QUESTIONS

1. ___________ is increasing Leadership rapidly:

   A. Strategy

   B. Command

   C. Control

   D. Getting others to follow

   Answer – D

2. Regarding leadership, which statement is false?

   A. Leadership does not necessarily take place within a hierarchical structure of an organisation

   B. When people operate as leaders their role is always clearly established and defined

   C. Not every leader is a manager

   D. All of the above

   Answer – B

3. __________ are the approaches to the study of leadership which emphasise the personality of the leader:

   A. Contingency theories

   B. Group theories

   C. Trait theories

   D. Inspirational theories

   Answer - C:

4. The effectiveness of a leader is dependent upon meeting _______ areas of need within the workgroup:

   A. One

   B. Three

   C. Five

   D. None of the above

   Answer – B

5. Needs, setting standards and maintaining discipline, and appointing sub-leaders according to Adair's approach, called as:

   A. Work functions

   B. Task functions

   C. Individual functions

   D. Team functions

   Answer – D

6. Which of the following is an assumption in Maslow's hierarchy of needs?

A. Needs are dependent on culture and also on social class

B. Lower-level needs must be at least partially satisfied before higer needs can affect behaviour.

C. Needs are not prioritized or arranged in any particular order.

D. Satisfied needs are moitvators, and new needs emerge when current needs remain unmet

Answer – B

7. The motivational process and not the motivators as such is associated with

A. Need hierarchy theory

B. Two factor theory

C. Berg theory

D. Expectancy theory

Answer - A

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5

FINANCIAL MANAGEMENT

Unit Structure :

5.0 OBJECTIVES

After studying the unit the students will be able to :

- Understand the concept of Finance and Financial Management
- Know the types of Financial Decisions
- Apprehend the Functions of Financial Management
- Analyse the concepts of Capital Budgeting
- Understand the need and importance of Capital Budgeting
- Discuss the various types of Capital Budgeting decisions
- Analyse the process of Capital Budgeting

- Explain the concept of Capital Structure Theories
- Analyse the Factors affecting Capital Structure
- Realize the meaning and importance of Capital Market
- Describe the different Constituents in the Capital Market
- Analyse the various Functions of Capital Market
- Describe Fundamental Analysis
- Know the various methods of Technical Analysis
- Understand the concept of Venture Capital
- Describe Demat Account
- Analyse the different Futures and Options
- Apprehend the above concepts and solve the Case Study

5.1 MEANING AND DEFINITION OF FINANCIAL MANAGEMENT

5.1.1 : MEANING OF FINANCE

Finance is the soul of every business entity and nobody can imagine theworld without finance. When we mention 'Finance', usually it means money, but it is merely not the money, it is a vast concept which is concerned with money and its flow or we can say, it is the source of providing funds for a particular activity. The word 'Finance' is a French word which means 'Management of Money'.

Finance is such a powerful medium that, it performs an important role toOperate, co-ordinate and controlthe various economic activities of the business enterprise. Finance is also limited resource like other resources and a business entity needs tomanage its finances resourcefully, effectively and efficiently.

5.1.2 : DEFINITION OF FINANCE

Finance is defined in numerous ways by different groups of people. Though it is difficult to give a perfect definition of Finance following selected statements will help to deduce its broad meaning.

In General sense, "Finance is the management of money and other valuables, which can be easily converted into cash."

According to John J. Hampton, the term finance can be defined as 'The management of the flows of money through an organization, whether it will be a corporation, school, bank or government agency.'

In the words of F.W.Paish, "Finance may be defined as the position of money at the time it is wanted."

Howard and Upton says, “Finance may be defined as that administrative area or set of administrative functions in an organization which relates with the arrangement of each and credit so that the organization may have the means to carry out the objectives as satisfactorily as possible.

According to Bonneville and Dewey, Financing consists in the raising, providing, managing of all the money, capital or funds of any kind to be used in connection with the business.

According to Experts, "Finance is a simple task of providing the necessary funds (money) required by the business of entities like companies, firms, individuals and others on the terms that are most favorable to achieve their economic objectives."

The Encyclopedia Britannica defines finance as “the act of providing the means of payment.” It is thus the financial aspect of corporate planning which may be described as the management of money.

According to Entrepreneurs, "Finance is concerned with cash. It is so, since, every business transaction involves cash directly or indirectly."

According to Academicians, "Finance is the procurement (to get,obtain) of funds and effective (properly planned) utilization offunds. It also deals with profits that adequately compensate for thecost and risks borne by the business."

Finance therefore represents the resources by way funds needed for a particular activity. Thus 'finance' is only referred in relation to a proposed activity. Finance goes with commerce, business, banking etc. Finance is also referred to as "Funds" or "Capital", when referring to the financial needs of a corporate body.

Therefore Finance is essential for expansion, diversification, modernization, as well as for establishment of new projects, viz. The financial policy of any organization mainly determines not only its existence and survival but also the performance and success of that organization. Finance is required for investment purposes and also to meet substantial capital expenditure projects.

5.1.3 : FINANCIAL MANAGEMENT

As finance is a scarce resource, it must be systematically raised form the cheapest source of funds and must be judiciously utilized for the development and growth of the organization.

Financial Management is a managerial process that is concerned with the planning, organizing, directing and controlling of financial resources.

It also helps in monitoring the effective deployment of funds in fixed assets and in working capital.

It aims at ensuring that adequate cash is on hand to meet the required current and capital expenditure. It facilitates ensuring that significant capital is procured at the minimum cost to maintain adequate cash to meet any requirementswhichmight arise in the future. It enhances market value of the firm through efficient and effective financial management.

Financial management helps in ascertaining and managing not only current requirements but also future needs of an organization. It influences the profitability of a firm.Financial management is very much required for the survival, growth, expansion and diversification of business. It is required to ensure purposeful resource allocation.

The financial manager is concerned with the efficient allocation of funds. He plays vital role in investment and financing decisions of the business enterprise.

It is concerned with providing solutions to problems like investment, financing and dividend decisions of the financial activities of an organization.

Capital Budgeting and capital structure designing of an organization is one of the important functions of Financial Management.

5.1.4 : DEFINITIONS OF FINANCIAL MANAGEMENT

"Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business." – Guthman and Dougal

"Financial management is that area of business management devoted to a judicious use of capital and a careful selection of the source of capital in order to enable a spending unit to move in the direction of reaching the goals." – J.F. Brandley

"Financial management is an application of general managerial principles to the area of financial decision-making". - Howard and Uptron

"Financial management is an area of financial decision making, harmonizing individual motives and enterprise goal". - Weston and Brighem

"Financial management is concerned with the efficient use of an important economic resource, namely capital funds" - Solomon Ezra & J. John Pringle.

"Financial Management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations" - Joseph & Massie

"Financial Management is concerned with managerial decisions that result in the acquisition and financing of long-term and short-term credits of the firm. As such, it deals with the situations that require selection of specific assets (or combination of assets), the selection of specific liability (or combination of liabilities) as well as the problem of size and growth of an enterprise. The analysis of these decisions is based on the expected inflows and outflows of funds and their effects upon managerial objectives". - Phillippatus.

5.1.5 : TYPES OF FINANCIAL DECISIONS

The modern approach of Financial Management takes a broad view of the term Financial Management and provides an analytical and conceptual framework for financial decision making. As such, the finance function includes both the acquisition and allocation of funds. Apart from the issues involved in acquiring external funds, the primary goal of financial management is the efficient and prudent allocation of funds to various uses.

In a broader context, it is regarded as an essential component of overall management.

The new method is an analytical way of looking at a company's financial problems like:

What is the total amount of funds that an enterprise should commit?

What specific assets should a company purchase?

How should the necessary funds be raised?

These are the main aspects of this method.

Alternatively, the following are the main components of the modern approach to financial management:

1. How large should an enterprise be, and how quickly should it grow?
2. In what form should assets be held?
3. How should its liabilities be structured?

The three questions raised above cover the major financial issues confronting a company. In other words, according to the new approach, financial management is concerned with the resolution of three major problems relating to a firm's financial operations, pertaining to the three questions of investment, financing, and dividend decisions.

Financial decisions refer to decisions concerning financial matters of a business firm. There are many kinds of financial management decisions that the firm makes for maximizing shareholders' wealth, like types of assets to be acquired, pattern of capitalisation, distribution of firm's income, etc.

These decisions can be classified into four major groups:

1. The Investment Decision;
2. The Financing Decision;
3. The Dividend Policy Decision.
4. Liquidity decisions

It is concerned with providing solutions to problems like investment, financing and dividend decisions of the financial activities of an organization.

1) Investment Decisions / Capital Budgeting Decisions :

Investment Decisions relates to the determination of total amount of assets to be held in the firm, the composition of these assets and the business risk complexities of the firm as perceived by the investors. It is concerned with the selection of both long-term and short-term assets in which a firm's funds will be invested. Long-term assets or fixed assets will generate a return over time; whereas short-term assets, or currentassets, are those that can be converted into cash within a financial period, such as a year.

It is the most important financial decision. Since funds involve cost and are available in a limited quantity, its proper utilization is very necessary to achieve the goal of wealth maximisation.

The investment decisions can be classified under two broad groups:

1. Long-term investment decision and

2. Short-term, investment decision.

The long-term investment decision is referred to as the Capital Budgeting and the short-term investment decision as Working Capital Management.

It is concerned with the selection of both long-term and short-term assets in which a firm's funds will be invested. Long-term assets, or fixed assets, will generate a return over time, whereas short-term assets, or current assets, are those that can be converted into cash within a financial period, such as a year.

Capital budgeting refers to long-term investment decisions, while working capital management refers to short-term investment decisions. Capital budgeting can also refer to long-term planning for allocating funds among various investment options. Risk and uncertainty analysis is a critical component of capital budgeting decisions. Because the return on investment proposals can be derived for a longer period of time in the future, the capital budgeting decision should be weighed against the risk associated with it. This method aids in determining the assets' 'Net Present Value.'

The financial manager, on the other hand, is also in-charge of the efficient management of current assets, also known as working capital management. Working capital is an essential component of financial management. These decisions include whether to invest funds in inventory, cash, bank deposits, or other short-term investments. They have a direct impact on the liquidity and performance of the business.

2) Financing Decisions :

Once the firm has taken the investment decision and committed itself to new investment, it must decide the best means of financing these commitments. Since, firms regularly make new investments; the needs for financing and financial decisions are on going, hence, a firm will be continuously planning for new financial needs. The financing decision is not only concerned with how best to finance new asset, but also concerned with the best overall mix of financing for the firm.

A finance manager has to select such sources of funds which will make optimum capital structure. The important thing to be decided here is the proportion of various sources in the overall capital mix of the firm. The debt-equity ratio should be fixed in such a way that it helps in maximising the profitability of the concern. The raising of more debts will involve fixed interest liability and dependence upon outsiders. It may help in increasing the return on equity but will also enhance the risk. The raising of funds through equity will bring permanent funds to the business but the shareholders will expect higher rates of earnings. The financial manager has to strike a balance between anxious sources so that the overall profitability of the concern improves. If the capital structure is able to minimise the risk and raise the profitability then the market prices of the shares will go up maximising the wealth of shareholders.

These decisions deal with the mode offinancing or mix of equity capital and debt capital.

Finance acquisition decisions must be made by the finance manager.It must be decided whether the entire required capital should be raised inthe form of equity capital or whether the amount should be from the loanfund. Even the timing of capital acquisition should be well defined. In afirm's financing decisions, there is a conflict between return and risk.

As aresult, the financial manager must strike a balance between risk and returnby maintaining the proper balance of debt and equity capital. On the otherhand, it is also the financial manager's job to identify an appropriatecapital structure. The ideal capital structure would always maximizewealth.

3) Dividend Decisions :

The third major financial decision relates to the disbursement of profits back to investors who supplied capital to the firm. The term dividend refers to that part of profits of a company which is distributed by it among its shareholders. It is the reward of shareholders for investments made by them in the share capital of the company. The dividend decision is concerned with the quantum of profits to be distributed among shareholders. A decision has to be taken whether ail the profits are to be distributed, to retain all the profits in business or to keep a part of profits in the business and distribute others among shareholders. The higher rate of dividend may raise the market price of shares and thus, maximise the wealth of shareholders. The firm should also consider the question of dividend stability, stock dividend (bonus shares) and cash dividend.

The decision will be based on the shareholder's preferences, investmentopportunities within the firm, and opportunities for future growth of the firm. The dividend payout ratio must be determined in light of the goal ofincreasing the share's market value. As a result, the dividend decision hasbecome a critical component of the financing decision. Dividend decision-makingmust be evaluated with respect to the firm's financing decisions todecide the part of retained earnings to be used as direct financing for thecompany's future expansions.

These decisions determine the division of earnings between payments to shareholders and reinvestment in the company.

4) Liquidity Decisions :

Liquidity and profitability are closely related. Obviously, liquidity and profitability goals conflict in most of the decisions. The finance manager always perceives / faces the task of balancing liquidity and profitability. The term liquidity implies the ability of the firm to meet bills and the firm's cash reserves to meet emergencies whereas profitability aims to achieve the goal of higher returns. As said earlier, striking a proper balance between liquidity and profitability is a difficult task. Profitability will be affected when all the bills are to be settled in advance. Similarly, liquidity will be affected if the funds are invested in short term or long term securities. That is the funds are inadequate to pay-off its creditors. Lack of liquidity in extreme situations can lead to the firm's insolvency.

5.2 FUNCTIONS / GOALS OF FINANCIAL MANAGEMENT

Financial Management is a managerial process that is concerned with the planning, organizing, directing, and controlling of financial resources.

Initially, financial management was concerned only with the collection of funds. Later on, proper utilization of funds also became an important aspect of Financial Management. In today's world, Financial Management examines all financial issues of a company.

Financial Management involves functions like :

- Fund procurement
- Working capital management
- Capital budgeting and capital structure designing of an organization
- Controlling and managing an organization's financial assets
- Making strategies related to expansion, diversification, joint venture, and mergers & acquisitions.

Following are the important goals of financial management :

1. Profit Maximization :

The objective of making profit is an important motive of every commercial business entity. Profit generation is essential for survival and growth of the business. Profit generation is also regarded as a measure of success of the business. Profit is an important yardstick for measuring the economic efficiency of any firm. Any business would be making the use of economic and human resources available to generate profits. The cost of these resources is required to be met of the revenue generated from the use of these resources and the surplus remaining would be needed for the growth and expansion of the company.

It is only an efficiently run business which can afford to meet the cost of resources and generate profits. Therefore, the survival and growth of any business depends upon its ability in earnings profits. It is therefore contended that profit maximization is one of the primary goals of the organization without which the survival of the organization itself is threatened.

2. Wealth Maximisation :

According to this objective, the owners of the company i.e. the shareholders are more interested in maximizing their wealth rather than in profit maximization. Maximization of the wealth of the shareholders means maximizing the net worth of the company for its shareholders. This reflected in the market price of the shares held by them. Therefore, wealth maximization means creation of maximum value for company's shareholders which mean maximizing the market price of the share.

Wealth maximization refers to the gradual increase in value of the net assets of the organization. Profit generation adds to the increase in the value of the net assets of the organization. With greater profits, the EPS (earnings per share) goes up; resulting an increase in the value of the net assets belonging to the shareholders of the company.

The market price of the shares is an important indicator of the wealth maximization of the organization. Wealth maximization is the net present value of a financial decision. Net present value is the difference between the gross present value of the revenue generated from such decision and the cost of such decision. A financial action with a positive net present value creates wealth and therefore is desirable. The total cash inflows over the years in terms of present value must be greater the outflows of cash invested for generating such cash inflows. This results in financial advantage leading to increase in the value of net assets. The increase in the value of net wealth should in turn help in generating greater volume of profits. This action results in financial gains to the shareholders increasing the earnings per share.

Therefore, the goal of wealth maximization implies a long term perspective of the goal. The interest of the management in maximizing the market price of the share is compatible with that of the shareholders' interest. This helps the management in allocating the resources in the best possible manner balancing the risks and the returns.

3. Other goals or functions of Financial Management :

i. To ensure adequate returns to the shareholders which should be fair in the given market conditions.

ii. To contribute to the operational efficiency of all other areas of management.

iii.To infuse financial discipline in the organization.

iv. To build up a strong financial base so that the enterprise can fall back upon its reverses during lean years and withstand the shocks of the business.

5.3 CAPITAL BUDGETING - INTRODUCTION

5.3.1 : MEANING OF BUDGET

The word 'Budget' is derived from the Old French term"Bougette" (little bag).

The first pronunciation of the term 'Budget' was done by Sir Robert Walpole (British Prime Minister and Chancellor of the Exchequer) during his annual financial statement in the year 1733.He said to "open" his budget, i.e. the container of documents and accounts.

The term 'Budget' is specifically used in the Government departments, businesses and individuals along with people and households at any income level. Budget means to plan for future. A budget is the total amount of money allocated for a particular purpose during a particular period of time. A budget is a financial or spending plan based on your income or revenue. It estimates the amount of money you'll spend based on how much you make in a given period.

During the early years Budgetary Control hasbecome a very popular technique of cost control. Now a days it exists in almost all the organizations in various forms. Capital Budget is one of theforms of Budgeting.

5.3.2 : MEANING OF CAPITAL EXPENDITURE

A 'Capital Expenditure' is an expenditure incurred for acquiring or improving the fixed assets, the benefits of which are expected to be received over a number of years in future. The capital expenditures means the expenditures incurred on acquiring or for extension of the long-term asset. Capital Asset or a Long-term asset may be a new building, a new machinery or a new project.

The following are some of the examples of capital expenditure.

i) Cost of acquisition of permanent assets such as land & buildings, plant & machinery, goodwill, etc.

ii) Cost of addition, expansion, diversification, improvement or alteration in the fixed assets.

iii) Cost of replacement and modernization of permanent assets in case of Obsolescence and Wear and Tear of the old equipments.

iv) Research and Development project cost for Product and for improving the productivity, etc.

v) Capital expenditure involves non-flexible long term commitment of funds.

5.3.3 : MEANING OF CAPITAL BUDGETING

The final Objective of each organization is to earn more and more profit.

Hence to plan and control the capital expenditure to achieve the targeted profitis the significant function of every business enterprise.

Capital Budget relates to the investment decisionsin capital expenditures. Capital expenditure decisions include current (expenditures), the benefits of which are expected to be received over a long period of time exceeding one year. The term Capital Budget is used interchangeable with Capital Expenditure Decision, Long Term Investments Decision.

The Finance Manager has to study and assess the profitability of various future long term projects before committing the funds. The investment proposals should be evaluated in terms of itsexpected profitabilitythrough the systematic investment programme viz. costs involved and the risks associated with the projects. That is the main role of Capital Budgeting. As per firm's cash flows and availability of funds Capital Budgeting should be essentially done.

Capital Budgeting involves the preparation of Cost and Revenueestimates for all the possible projects, an examination of the merits anddemerits of each and every possibility and finally selection of the projectgiving the highest return on investment. The Capital Budget includes theplanning and utilization of available capital to increase the profitability ofthe business organization.

Capital Budgeting means planning for capital assetsand management of fixed assets.It is a complex process as it involves decisions relating to the investment of current funds for the benefit to be achieved in future.

Capital Budgeting is budgeting for capital projects.

Capital Budgeting refers to long-term investment decisions. Capital Budgeting can also refer to long-term planning for allocating funds amongvarious investment options.

Capital Budgeting is the decision-making process concerned with whether or not :

(i) The firm should invest funds in long term projectto make profit and

(ii) How to choose among competing projects.

The long-term activities are those activities that influence firms' operation beyond the one year period. The basic features of Capital Budgeting decisions are:

(a) There is an investment in long term activities

(b) Current funds are exchanged for future benefits

(c) The future benefits will be available to the firm over series of years.

5.3.4 : DEFINITION OF CAPITAL BUDGETING

1. "Capital Budgeting is long-term planning for making and financing proposed capital outlay". - Charles T. Horngreen.
2. "The Capital Budgeting generally refers to acquiring inputs with long-term returns". – Richards &Greenlaw.
3. "Capital Budgeting involves the planning of expenditure for assets, the returns from which will be realized in future time periods". - Milton H. Spencer.

5.4 NEED AND IMPORTANCE OF CAPITAL BUDGETING

5.4.1 : NEED OF CAPITAL BUDGETING

According to Joel Dean (American Economist), "The capital expenditure budget holds a company's plans for replacing, improving and adding to its capital equipment." These words show that Capital Budgeting is ainevitable function of management. Capital Budgeting is significant for survival and growth of the organization as it is related to the decisions of long-term investment.

The investment decision is important not only for the setting up of new units but also for the expansion of present units, replacement of permanent assets, research and development project costs and reallocation of funds, if investments made earlier do not bring result as per the expectations.

Capital Budgeting decisions are very important in financial decisions, because efficient allocation of capital resources is one of the most crucial decisions of financial management.The right decision made by the process of Capital Budgeting will help thecompany to maximize the shareholder value which is the primary goal of any business.

The overall objective of Capital Budgeting is to maximize the profitability of the firm in way of the return on investment.

It is significant because it deals with right kind of evaluation of projects.

In Capital Budgeting decisions a project is accepted if it has positive net cash flows.

Positive cash flow means Excess of present Value of Cash inflows overthe Present investment value.

E.g. A Co. Planning to buy a Machinery for ₹ 1,00,000 and its useful lifeis 5 years cash flow expected from these investment is ₹ 22,000 Per year.

Here,

Particulars	Amount (₹)
Total Cash Inflow : (22000 X 5 Years)	1,10,000
Less: Total Investment	(1,00,000)
Net Cash flow (Positive)	**10,000**

Capital Budgeting involves identification of all cash outflows (Capital Investment, expenses related to capital investment) & all Cash Inflows (Receipts from employment of capital Assets &all other receipts from Capital Assets e.g. scrap value on sale of capital asset.)

5.4.2 : IMPORTANCE OF CAPITAL BUDGETING

i) For Careful Investment Decisions-

As the capital investment is a long-term investmentwhere involvement of investment is huge and benefits are expected in future years.Hence if once thedecision has been taken, it becomes very difficult to reverse it. Evenany modification or alternation becomes impossible.Capital Budgeting helps in taking careful capital expenditure decisions.

ii) For overcoming Risk & Uncertainty-

Capital investment decisions involve risk anduncertainty due to huge investment. The future Cash Inflows are justestimated cash inflows and not the actual cash inflows. Therefore cautious and thoughtful Capital Budgeting decisions become significant for overcoming Risk & Uncertainty.

iii) For avoiding over and under investment-

Capital Budgeting includes the decisions about acquisition of assets andan estimation of earnings from of such assetsduring its life span. An incorrectdecision in this matter leads to over or under investment. Both thesituations are risky from the profitability point of view. Hence properplanning of capital expenditure is essential.

iv) For avoiding unnecessary blockingof funds -

The main feature of Capital Budgeting is to ensure the proper timing of acquisition of assets. If the assets are not acquired on proper time, it is theunessential blocking of funds. It results into loss of revenue.

v) For arranging the necessary finance in time-

Capital Budgeting means the estimation of capital investment decisions.Therefore it enables the organization to arrange the necessary fundsin time for long-term investment.

vi) For looking into the various aspects and alternatives-

Capital Budgeting decisions may have positive or negative impacts on business entity, industry and on economy at large. In-depth study/ analysis of various projects, proposals and their various aspects is a significant stagein the process of Capital Budgeting. It ensures that the investment will bemade in the most profitable project or proposal. Capital Investment proposals if properly analysed and selected can result in increase in profitability and Sales. It increases the productivity of the business entity and finally the overall economy of the country.Alternatively it will result in increasing the wealth of the investors/shareholders.

vii) Foranalysing and evaluating the technological changes-

For facing cut-throat competition,analysis of technological changes isnecessary. To explore and evaluate the technological changes is theimportant function of Capital Budgeting. The cost ofproductiondecreases thorough exploration,evaluation and application of advanced techniques as well as it increases the probability which enables the business entityfor facing the cut-throat competition.

5.5 TYPES OF CAPITAL BUDGETING DECISIONS

The overall objective of Capital Budgeting is to maximize the profitability of a firm or the Return On Investment (ROI). This objective can be achieved either by increasing the revenues or by reducing costs. Thus, Capital Budgeting decisions can be broadly classified into two categories:

I. Investment Decisions which Increases Revenues :

It means the decision are taken in expectation of increasing the revenue of the firm through expansion of the production capacity or size of operations by adding new capital assets or new plant or introducing new product line.

II. Investment Decisions which Reduces Cost :

It means the decision are taken in expectation of increasing the revenue of the firm by reducing costs and includes decisions relating to replacement of obsolete, outmoded or worn out assets or old asset or old plant. In such cases, a firm has to decide whether to continue with the same asset or replace it. Such a decision is taken by the firm by evaluating the benefit from replacement of the asset in the form of reduction in operating costs and the cost/expenditures (outlay) needed for replacement of the asset which ultimately reduces the cost.

Both categories of above decisions involve investment in fixed assets but the basic difference between the two decisions lies in the fact that Increasing Revenue Investment Decisions are subject to more uncertainty as compared to Cost Reducing Investment Decisions.

Further, in view of the investment proposals under consideration, Capital Budgeting decisions may also be classified as:

1. Accept / Reject Decisions

2. Mutually Exclusive Project Decisions

3. Capital Rationing Decisions

1) Accept / Reject Decisions :

Accept / Reject decisions relate to independent project/ proposal which do not compete with one another. Such decisions are generally taken on the basis of minimum Return On Investment (ROI). All those proposals which yield a rate of return higher than the minimum required Rate Of Return (ROR) or the Cost Of Capital (CoC) are accepted and the rest are rejected. If the proposal is accepted, the firm makes investment in it and if it is rejected the firm does not invest in the same.

2) Mutually Exclusive project Decisions :

Such decisions relate to projects/ proposals which compete with one another in such a way that acceptance of one automatically exclude the acceptance of the other. Thus, one of the proposals is selected at the cost of the other.

For example, a company may have the option of buying a new machine or a second hand machine or taking an old machine on hire or selecting some machinesfrom more than one brand available in the market. In such a case, the company may select one best alternative out of the various options by adopting some suitable technique or method of Capital Budgeting. Once one alternative is selected the others are automatically rejected.

3) Capital Rationing Decisions :

A firm may have several profitable investment proposals but only limited funds to invest. In such case, these various investments compete for limited funds and thus the firm has to ration (Allotment in appropriate share or portion accordingly) them. The firm effects the combination of proposals that will yield the greatest profitability by ranking them in descending order of their profitability.

5.6 PROCESS OF CAPITAL BUDGETING

5.6.1 : PROCESS OF CAPITAL BUDGETING

The important steps involved in the Capital Budgeting process are :

1. Project Generation

2. Project Analysis

3. Project Selection

4. Project Execution.

5. Monitoring and Evaluation

1) Project Generation :

In a dynamic and progressive firm there is a continuous flow of profitable investment proposals. Investment proposals of various types may originate at different levels within a firm. Investment proposals may be either proposals to add new product to the product line or proposals to expand capacity in existing product lines. Moreover, proposals designed to reduce costs of the output of existing products without changing the number of operations.

2) Project Analysis :

Project Analysis involves two steps:

i) Estimation of benefits (cash flows or profits) and costs (outlays or expenditures) and

ii) Selection of an appropriate criterion to judge the desirability of the projects.

All the project proposals are analyzed by forecasting their cash flows to determine expected profitability of each project.The analysis of projects should be done by an unbiased group. The criterion selected must be consistent with the firm's objective of maximizing its market value.

3) Project Selection :

Once the profitable projects are shortlisted, they are prioritized according to the available company resources, a timing of the cash flows of the project and the overall strategic plan of the company. There is no uniform selection procedure for investment proposals. Since Capital Budgeting decisions are of vital importance, the final approval of the projects rest on the top management.

4) Project Execution ;

After the final selection of investment proposals which fits the company's strategy, funds are assigned for capital expenditures. Funds for the purpose of project execution should be spent in accordance with appropriations made in the capital budget.

5) Post completion Monitoring and Evaluation(with Post-Auditing) :

Monitoring the execution of projects is also a vital stage in the process of Capital Budgeting. The thorough follow-up on the actual execution of the project includes the comparison of actual results of the project with forecasted results and arrives at deviation if any. Systematic errors in cash-flows are recognized in the post-audit. The deviations and errors are evaluated and corrections are done for future benefits from it.

5.6.2 : PROJECT EVALUATION / INVESTMENT EVALUATION

Capital Budgeting is a dual-purpose technique that analyses investment opportunities and cost of capital simultaneously while evaluating worthiness and viability of a project. A wide range of criteria has been suggested to judge the usefulness of investment projects. Capital projects need to be evaluated in-depth with their costs and benefits. The costs of capital projects include the initial investment at the commencement of the project. Initial investment made in land, building, plant, machinery, equipment, furniture, fixtures, etc. generally contributes to the installed capacity.

5.6.3 : CRITERIA FOR EVALUATION OF PROJECT / INVESTMENT

The Capital Budgeting process begins with collecting of investment proposals of different departments of a firm. The departmental head will have numerous alternative projects available to meet his demands. He has to select the best alternative from the competing proposals. This selection is made after estimating return (profit or yield) on the projects and comparing the same with the Cost of Capital (CoC). Investment proposal which gives the highest net marginal return will be chosen.

Following are the steps involved in the evaluation of an investment:

1) Estimation of cash flows

2) Estimation of the required rate of return

3) Application of a decision rule for making the choice

5.6.4 : FEATURES ESSENTIAL FOR INVESTMENT EVALUATION CRITERIA

A comprehensive appraisal technique should be used to measure the economic worthiness of an investment project. Porter field, J.T.S. in his book, 'Investment Decisions and Capital Costs', has outlined some of the features which must exist in comprehensive investment evaluation criteria.

i) It should consider all cash flows to determine the true profitability of the project.

ii) It should provide an objective and definite technique of separating good projects from bad projects.

iii) It should help ranking of projects according to their true profitability.

iv) It should recognize the fact that bigger cash flows are preferable to smaller ones and early cash flows are preferable to later ones.

v) It should help to choose among mutually exclusive projects which maximize the shareholders' wealth.

vi) It should be a criterion which is applicable to any conceivable investment project independent of others.

5.6.5 : TYPES OF EVALUATION TECHNIQUES

Types of EvaluationTechniques

Traditional / Non-Discounted Cash-Flow Techniques

1) Pay-back Period Method
2) Average or Accounting Rate of Return (ARR)

Time-Adjusted / Discounted Cash-Flow Techniques

1) Discounted Pay-back Period Method
2) Net Present Value (NPV) Method
3) Benefit-Cost Ratio (Profitability Index)
4) Internal Rate of Return (IRR) Method
5) Modified Internal Rate of Return Method

I. Traditional / Non-Discounted Cash-Flow Criteria (Techniques) :

Traditional techniques are also called 'Non time adjusted'or 'Non-Discounted Cash-Flow' techniques because it does not consider time value of money.

II. Discounted Cash-Flow Criteria (Techniques) :

Discounted cash flow Techniques arealso called 'Time adjusted' techniques because it considers time value ofmoney.

You will learn the different Evaluation Techniques of 'Capital Budgeting'in detail with illustrations and solved problems in Module no. 2 : 'Capital Budgeting' of the subject : Financial Management – II in the same semester of your course.

5.7 CAPITAL STRUCTURE – MEANING

5.7.1 : CAPITAL STRUCTURE THEORIES – INTRODUCTION

A company can raise the required finance through two principal sources, namely equity and debt.

Therefore, a question should arise - what should be the proportion of debt and equity in the capital structure of the company? This can be put in a different manner – what should be the financial leverage of the company?

The company should decide as to how to divide its cash flows into two broad components – a fixed component earmarked to meet the debt obligation and the balance portion that genuinely belongs to the equity shareholders.

Any financial management should ensure maximization of the shareholders' wealth. Therefore an important question that should be raised and answered is what is the relationship between capital structure and value of the firm? Or what is the relationship between capital structure and cost of capital?

As cost of capital and firm value are inversely related, this assumes greater importance. If the cost of capital is very low, then the value of the company is maximized and if the cost of capital is very high, then the value of the company is minimized.

A firm has to maintain an optimum capital structure with a view tomaintain financial stability. The optimum capital structure can be obtainedwhen the market value per share is the maximum. Therefore, the objectiveof the firm should be taken to select a financing of debt equity mix whichwill maximise the value of the firm, optimum leverage can be the mix ofdebt-equity which maximises the value of a company.

In order to achievethis goal, the finance manages has to follow the theories of capitalstructure of corporate enterprises.

There are four major theories whichexplain the relationship between capital structure, cost of capital and valueof the firm.

These are as follows:

1. Net Income Approach.

2. Net Operating Income Approach.

3. Modigliani-Miller Approach (MM).

4. Traditional Approach.

However, in order to understand this relationship, following assumptionsare made:

i) The firm employs only two types of capital i.e. debt and equity capital.

ii) Taxes are not considered.

iii) The firm pays its earnings in full as dividend. There is no returnedearnings.

iv) The firm's total assets are given and there is no change in the assets.

v) The firm's total financing remains constant. The firm can change itscapital structure by interchanging the source of finance.

vi) The operating profit is not expected to change.

vii) The business risk remains constant and it is independent of capitalstructure and financial risk.

viii) The firm has a perpetual life. It means the business is a going concernand it has long life.

ix) All the investors has the same subjective probability distribution of thefuture expected operating profit for a given firm.

5.7.2 : MEANING OF CAPITAL STRUCTURE

Capital structure is the mix of different securities to a firm's capital.It is a part of a company's financial structure. It represents the mix ofdifferent sources of long term funds, in the capital of the company.

The long term sources of raising capital are issue of shares, debentures orbonds and long-term borrowings. The Share Capital is an owned capital and Debentures and bonds are borrowed capital. The capital structure of acompany is to be determined initially, at the time of formation of thecompany.

The term capital is used with reference to the total long term funds raised by acompany.

The decisions regarding the form of financing, their requirementsand their relative proportions in the total capital of a company are knownas 'capital structure decisions'.

The choice of capital structure depends upon a number of factors such as nature of business,regularity of earnings, conditions of the financial markets and attitudes ofthe investors. A capital structure will be considered appropriate if itpossesses profitability, solvency, flexibility, conservatism and control.

Capital structure refers to the mix of a firm's capitalization andincludes long-term source of fund such as debentures, preferenceshares, equity share, and retained earnings. The decision regardingthe forms of financing their requirements and their relativeproportions in total capitalization are known as capital structuredecision.

A firm has the choice to raise capital for financing itsproject from different sources in different proportions as follows:

i) Exclusive use of equity capital

ii) Use of equity and preference capital

iii) Use of equity and debt capital

iv) Use of equity, preference and debt capital

v)Use of a combination of debt, equity and preference capital in different proportions.

The choice of combination of these sources is called capitalstructure mix.

5.7.3 : OPTIMUM CAPITAL STRUCTURE

The theory of optimal capital structure deals with the issue of rightmix of debt and equity in the long term capital structure of a firm.This theory states that if a company takes on debt the value ofthe firm increases up to a point, beyond that point if debt continuesto increases then the value of the firm will start to decrease. if thecompany is unable to repay the debt within the specified period,then it will affect the goodwill of the company in the market .

Therefore, the company should select its appropriate capitalstructure with due consideration to the factors of debt and equity.

Policymakers should choose a capital structure that reflects thedesired mix of equity and debt capital. There are some debt-equityratio standards that must be followed in order to reduce the risks ofexcessive loans. For example, public sector organizations have a1:1 ratio, while private sector firms have a 2:1 ratio. It may differfrom industry to industry.

Thus companies will prefer to go after debt capital for the following reasons :

i) Tax deductibility of interest (availability of tax shield)
ii) Higher return to shareholders due to gearing
iii) Complicated, time consuming procedure for raising equity capital
iv) No dilution of ownership and control
v) Equity results in permanent commitment than debt.

5.7.4 : DECIDING CAPITAL STRUCTURE

The Capital structure of an enterprise refers to the kind and proportion of different securities for raising funds. After deciding about the requirement of funds, the kind and proportion of various sources of capital should be decided. It may be wise to finance fixed assets through long-term debts.

Even if gestation period is longer, then share capital may be most suitable. Long-term funds should be raised. The decisions regarding an ideal mix of equity and debt as well as short-term and long-term debt ratio will have to be taken in the light of the cost of raising finance from various sources, the period for which the funds are required. Long-term funds should be employed to finance working capital also, if not wholly then partially. Care should be taken to raise sufficient long-term capital in order to finance the fixed assets as well as the extension programme of the enterprise in such a wise manner as to strike an ideal balance between the own funds and the loan funds of the enterprise.

Entirely depending upon overdrafts and cash creditors for meeting working capital needs may not be suitable. A decision about various sources for funds should be linked to the cost of raising funds. If cost of raising funds is very high then such sources may not be useful for long.

The capital structure decision centres on the allocation between debt and equity in financing the business needs. An efficient mixture of capital reduces the price of capital. The Lesser cost of capital increases net economic returns which ultimately increase business value.

5.8 FACTORS AFFECTING CAPITAL STRUCTURE

5.8.1 : FACTORS AFFECTING CAPITAL STRUCTURE

Following are the factors which mainly influence in the decision of the perfect capital Structure:

1) Business Risk :

Business risk refers to the variability of a company's earnings and the potential for financial loss. Industries with higher business risk, such as technology or biotechnology, may prefer to have a lower proportion of debt in their capital structure. This is because high levels of debt can amplify the impact of fluctuations in earnings, leading to financial distress.

2) Cost of Capital :

The cost of capital is the cost a company incurs to raise funds. It includes the cost of equity and the cost of debt. Companies aim to minimize their overall cost of capital to maximize shareholder value. The relative costs of equity and debt financing influence the proportion of each in the capital structure.

3) Financial status of the enterprise :

Financial status or health is the ability of a company to adapt to changes in its operating environment. A balanced capital structure provides financial flexibility, allowing a company to fund new projects or navigate challenging economic conditions. Having a mix of equity and debt ensures that the company can access different sources of capital as needed.

4) Prevailing Tax regime :

Interest on debt is tax-deductible, providing a tax shield for companies. This makes debt financing more cost-effective compared to equity financing from a tax perspective. As a result, companies in higher tax brackets may choose to use more debt in their capital structure to reduce their taxable income.

5) Market situations :

Economic and market conditions impact a company's ability to raise capital. During economic downturns, credit may be less available, leading companies to be more conservative in their use of debt. In contrast, in favourable economic conditions, companies may be more willing to take on debt to fund expansion and growth opportunities.

6) Size of the company and product life cycle :

Smaller and younger companies may have limited access to debt markets and may rely more on equity financing to fund their operations. As a company grows and matures, it may have better access to debt markets and may use debt to take advantage of tax benefits and leverage.

7) Shareholders' preferences :

Investor preferences play a role in shaping a company's capital structure. Some investors, such as conservative institutional investors or those focused on income generation, may prefer companies with lower levels of debt due to the lower risk of financial distress. Other investors, including those seeking higher returns, may be more comfortable with companies that use more debt.

8) Financial Ratios :

Financial Ratios as the debt-to-equity ratio, provide insights into a company's financial risk. A higher debt-to-equity ratio indicates a higher level of financial leverage and risk. Companies carefully consider these ratios to ensure that the capital structure aligns with their risk tolerance and financial objectives.

9) Statutory and Regulatory requirements :

Industries and companies are subject to various regulations that may impact their capital structure decisions. Regulatory constraints, such as limits on the amount of debt that can be used, influence the financing options available to companies. Regulatory changes can also affect the attractiveness of certain financing instruments.

10) Credit Rating :

A company's credit rating reflects its creditworthiness and influences its ability to obtain debt financing. Higher credit ratings result in lower interest rates and better terms for debt. Maintaining a good credit rating is crucial for companies that rely on debt financing, as it enhances their ability to access capital at favorable terms.

As such, capital structure decisions involve a careful consideration of these factors, taking into account the unique characteristics of the company, its industry, and the prevailing economic and regulatory conditions. A well-balanced capital structure is essential for achieving financial stability and flexibility while optimizing the cost of capital.

5.8.2 : CAPITAL STRUCTURE DETERMINANTS IN PRACTICE

The capital structure determinants in practice may involve considerations in addition to the concerns about earning per share, value of the company and cash and funds flow.

A company may have enough debt servicing ability but it may not have assets to offer as collateral. Management of companies may not willing to lose their grip over the control and hence they not be taking up debt capital even if they are in their best interest.

Some of the very important considerations are briefly covered below:

1) Growth potential :

Companies with growth opportunities may probably find debt financing very expensive in terms of interest to be paid and this may arise due to non-availability of adequate unencumbered collateral securities. This may result in losing the investment opportunities.

High growth companies may prefer to take debts with lower maturities to keep interest rates down and to retain the financial flexibility since their performance can change unexpectedly at any point of time. They would also prefer unsecured debt to have flexibility.

Strong and mature companies have tangible assets and stable profits. Thus they may have low costs of financial distress. These companies would therefore raise debts with longer maturities as the interest rates will not be high for them and they have a lesser need of financial flexibility since their performance is not expected to be altered suddenly. They would also be availing the interest tax shields which in turn will enhance the value of the companies.

2) Assets :

The assets and the form of assets held by the companies are very important determinants of their capital structure.

Tangible unencumbered fixed assets serve as a collateral security to debt. In the event of any unforeseen financial distress, the creditors can have recourse to these assets and they may be able to recover their debt by foreclosing such assets.

Companies with large tangible assets will have very less financial distress and costs and they will be preferred by the creditors.

Companies with intangible assets will not have any such advantages.

3) Non debt and debt tax shields :

The tax provisions provide for deduction of interest paid on debt and therefore the debt capital can increase the company's after tax free cash flows. Therefore this interest shield increases the value of the company.

This tax advantage of debt implies that companies will employ more debt to reduce tax liabilities and increase value. In practice this is not always true as is evidenced from many empirical studies.

Companies also have non debt tax shields like depreciation, carry forward losses, etc. This implies that companies that have larger non debt tax shields would employ low debt as they may not have sufficient taxable profit to have the benefit of interest deductibility.

However, there is a link between non debt tax shields and the debt tax shields because companies with higher depreciation would tend to have higher fixed assets, which serve as collateral against debt

4) Financial flexibility :

Companies will normally have a low level of threat or insolvency perception even though their cash and funds flows are comfortable. Despite this, the companies may exercise conservative approach in their financial leverages since the future is very much uncertain and it may be difficult to consider all possible scenarios of adversity. It is therefore prudent for the companies to maintain financial flexibility as this will enable the companies to adjust to any change in the future events.

5) Loan agreements :

The creditors providing the debt capital would insist for restrictive covenants in the long term loan agreements to protect their interest.

Such covenants may include distribution of dividends, new additional external finances (other than equity issue) for existing or new projects, maintain working capital requirements at a particular level. These covenants may therefore restrict the companies' investment, financing and dividend policies. Violation of these covenants can lead to serious adverse consequences. To overcome these restrictive covenants, the companies may ask for and provide for early repayment provisions even with prepayment penalty provisions in the loan agreements.

6) Control :

In designing a suitable capital structure, the management of the companies may decide and desire to continue control over the companies and this is true particularly in the case of first generation entrepreneurs. The existing management team not only wants control and ownership but also to manage the company without any outside interference. Widely held and closely held companies may opt to pursue appropriate strategies to hold back their existing management controls.

7) Issue costs :

Issue or floatation costs are incurred when a company decides to raise debt capital in the market. These debt issue costs are normally expected to be lower than equity issue costs. This alone will encourage the companies to pursue debt capital. Retained earnings do not involve issue costs. The source of debt also influences the issue costs. Regulations like stamp duty on commercial paper or certificate of deposits may also jack up the issue cost for the companies.

You will learn the different 'Capital Structure theories' in detail with illustrations and solved problems in Module no. 3 : 'Capital Structure Theories' of the subject : Financial Management – II in the same semester of your course.

5.9 CAPITAL MARKET – MEANING AND IMPORTANCE

5.9.1 : CAPITAL MARKET – INTRODUCTION

Capital Market is a market for long-term sources of financeto the industrial and corporate sector. The development of a nation depends upon the rapid growth of industrialization of a country.

Asset formation is the crucial factor for prosperity of nation. Theasset creation is based on supply of capital and technology. Capitalalone will not create prosperity. The prosperity is the combination ofTechnology, Capital and Human Resources towards developed nation.

5.9.2 : DEFINITIONS OF CAPITAL MARKET

According to Arun K. Datta the Capital Market may bedefined as, "the Capital Market is a complex of institutionsinvestment and practices with established links between thedemand for and supply of different types of capital gains".

According to F. Livingston the Capital Market may be definedas, "In a developing economy, it is the business of the capitalmarket to facilitate the main stream of command over capital to thepoint of the highest yield. By doing so, it enables, control overresources to pass into the hands of those who can employ themmust effectively thereby increasing production capacity and spellingthe national dividend."

5.9.3 : IMPORTANCE OF CAPITAL MARKET

Capital Market deals with long-term funds. These funds are subject to uncertainty and risk. It supplies long and medium termfunds to the corporate sector. It provides the mechanism forfacilitating capital fund transactions. It deals in ordinary shares,bond debentures and stocks and securities of the government.

Inthis market the funds flow will come from savers. It converts financial assets into productive physical assets. It provides incentives to savers in the form of interest or dividend to theinvestors. It leads to capital formation.

The following factors play an important role in the growth of the Capital Market:

i) A strong and powerful Central Government

ii) Financial dynamics

iii) Speedy industrialisation

iv) Attracting Foreign Investment

v) Investments from NRIs

vi) Speedy Implementation of policies

vii) Regulatory changes

viii) Globalisation

ix) The level of savings and investment pattern of the householdsectors

x) Development of financial theories

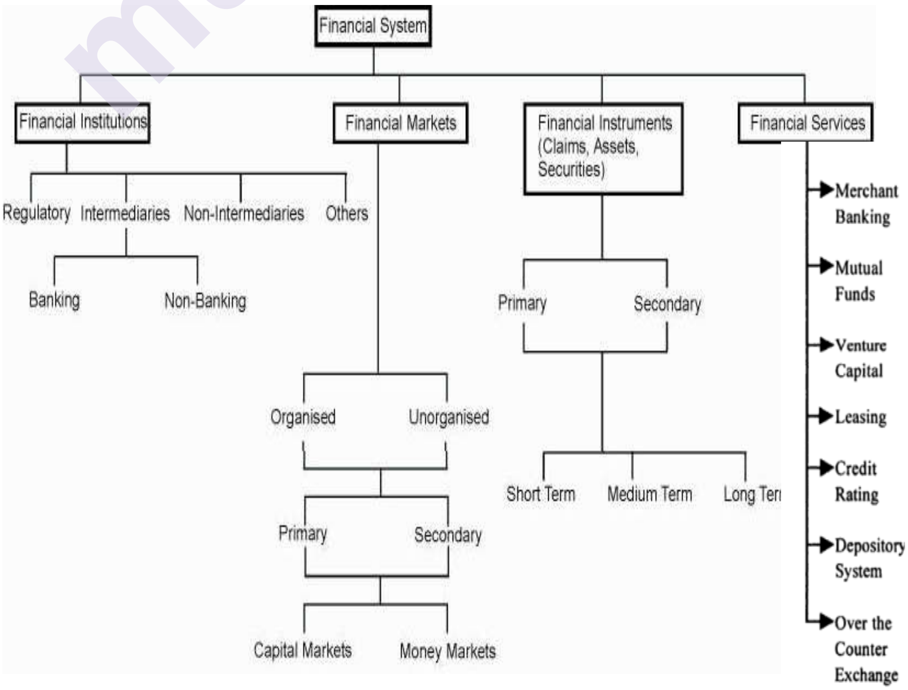
xi) Sophisticated technological advances

5.10 CONSTITUENTS IN THE CAPITAL MARKET

Constituents in the Capital Market can be studied with the help of financial system of India.

5.10.1 : FINANCIAL SYSTEM OF INDIA

Following chart depicts the Indian Financial System with its constituents :



5.10.2 : CONSTITUENTS IN THE CAPITAL MARKET

Capital Market is a market for long-term funds. It requires awell-structured market to enhance the financial capability of thecountry. The market consists of a number of players. They arecategorised as:

1. Companies
2. Financial Intermediaries
3. Investors

1) Companies :

Generally every public company can access the capitalmarket. The companies which are in need of finance for theirprojects can approach the market. The Capital Market provides funds from the savers of the community. The companies can mobilize the resources for their long-term needs such as projectcost, expansion and diversification of projects and otherexpenditure items.

In India, the companies should get the priorpermission from the SEBI (Securities Exchange Board of India) toraise the capital from the market. The SEBI is the most powerfulorganization to monitor, control and guide the Capital Market. It classifies the companies for the issue of share capital as newcompanies, existing, and unlisted existing listed companies.

According to its guidelines a company is a new company, if itsatisfies all the following conditions:

i. The company shall not have completed 12 months ofcommercial operations.

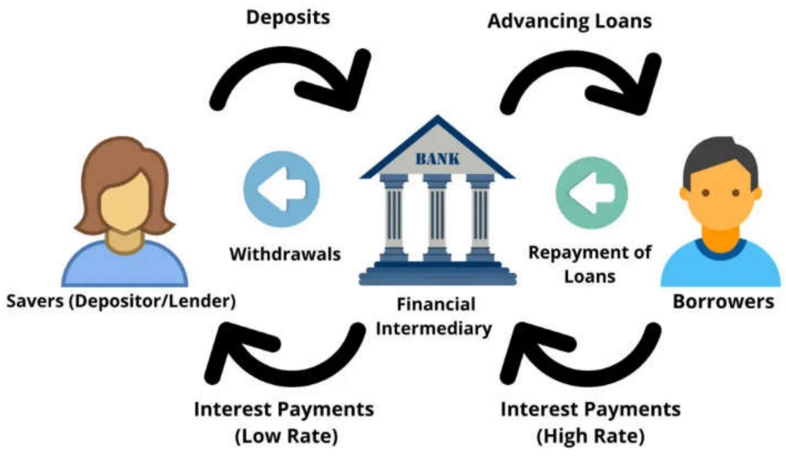
ii. Its audited operative results are not available.

iii. The company may set-up by entrepreneurs with or without trackrecord.

A company can be treated as existing listed company, if itsshares are listed in any recognised stock exchange in India. A company is said to be an existing listed company if it is a closelyheld or private company.

2) Financial Intermediaries :

Financial intermediaries are those who assist in the processof converting savings into capital formation in the country. A strongcapital formation process is the oxygen to the corporate sector. Therefore, the intermediaries occupy a dominant role in the capitalformation which ultimately leads to the growth of prospering to thecommunity. Their role in this situation cannot be neglected. Thegovernment should encourage these intermediaries to build astrong financial empire for the country. They can also be called asfinancial architectures of the Indian digital economy. Their networkcannot be ignored. Their financial capability cannot be measured.They take active role in the Capital Market.



The majorintermediaries in the Capital Market are:

i. Brokers

ii. Stock-brokers and sub-brokers

iii. Merchant Bankers

iv. Underwriters

v. Registrars

vi. Mutual Funds

vii. Collecting agents

viii. Depositories

ix. Agents

x. Advertising agencies

3) Investors :

The Capital Market consists of many numbers of investors. Alltypes of investor's basic objectives are to get good returns on theirinvestment. Every fund owner may desire to take away the fundafter a specific period. Therefore, safety is the most important factorwhile considering the investment proposal. The investors comprisethe financial and investment companies and the general publiccompanies. Usually, the individual savers are also treated asinvestors.

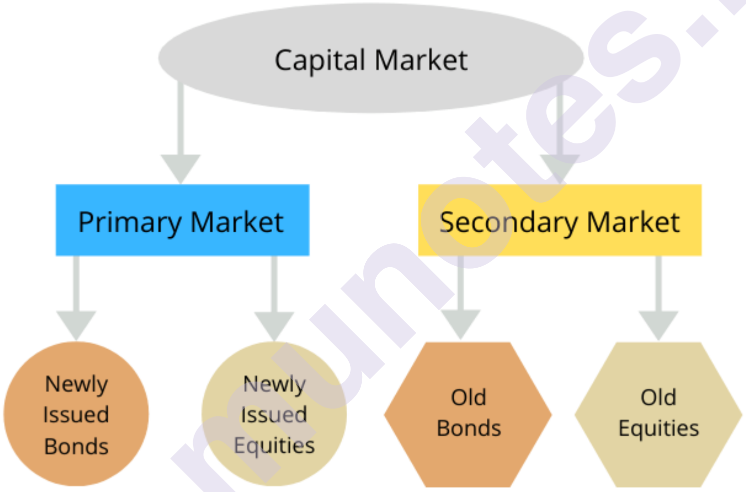
Return is the reward to the investors. Risk is thepunishment to the investors who wrongly made investmentdecision. Return is always chased by the risk. An intelligent investormust always try to escape the risk and capture the return. Allrational investors prefer return, but most investors are risk averse.They attempt to get maximum capital gain. The return can be madeavailable to the investors in two types and they are in the form ofrevenue or capital appreciation. Some investors will prefer forrevenue receipt and others prefer capital appreciation. It depends upon their economic status and the effect of tax implications.

Theinstitutions and companies raise the resources from the market bydesigning various schemes to meet the needs and convenience ofthe investors. They schemes can be framed to attract all types ofinvestors, who are selling in the Capital Market. The main objectiveof any type of investor is safety, profitability, liquidity and capitalappreciation.

5.10.3 : COMPONENTS OF THE CAPITAL MARKET

In a Capital Market, banks and financial institutions are theimportant components. They act as catalysts in the economicdevelopment of any country. These institutions mobilise financial savings from household, corporate and other sectors of theeconomy and channelize the into productive investments. They act as a Reservoir of resources of Financial Markets and form thebackbone of the economic and financial system. The Bankingindustry has undergone a sea change during the last threedecades. After the modernisation of banks, they not only lend forthe Social and Economic causes but also participated in thedevelopment programmes of Central Government and StateGovernment.

The main components of the Capital Market in India are:



1. New-issue Market (Public issues) (Primary Market)

2. Secondary Market (Stock Market)

The Indian Capital Market is regulated by TheSecurities and Exchange Board of India (SEBI).

5.10.4 : STRUCTURE OF THE CAPITAL MARKET IN INDIA

The structure of the Capital Market has undergone vastchanges in recent years. The Indian Capital Market has transformedinto a new appearance over the last four and half decades.

Now itcomprises an impressive network of financial institutions andfinancial instruments. The market for already issued securities hasbecome more sophisticated in response to the different needs ofthe investors. The specialised financial institutions were involved inproviding long-term credit to the corporate sector. Therefore, the premier financial institutions such as ICICI, IDBI, UTI, LIC and GIC constitute the largest segment.

A number of new financialinstruments and financial intermediaries have emerged in theCapital Market.

Usually the Capital Markets are classified in twoways:

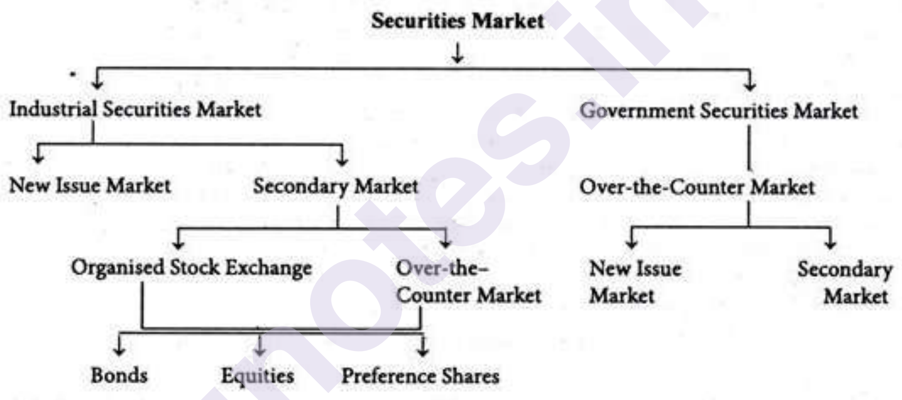
1. On the basis of issuer.

2. On the basis of instruments.

1) On the basis of issuer the Capital Markets can be classified again into two types :

i. Corporate (Industrial) securities market.

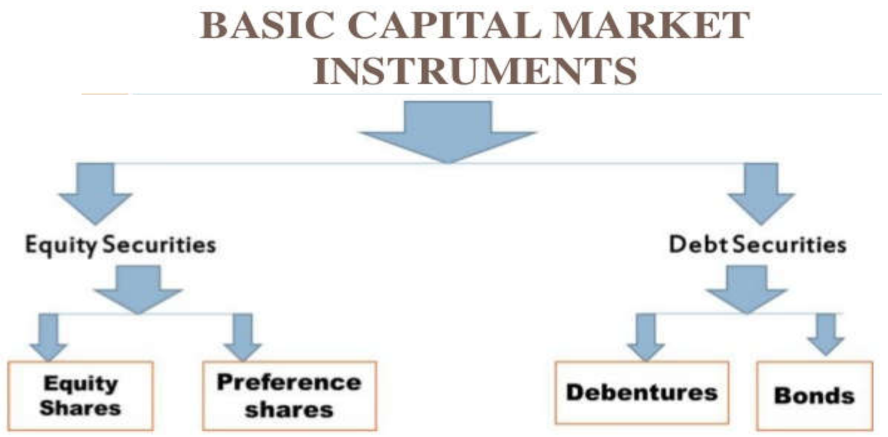
ii. Government securities market.



2) On the basis of financial instruments the Capital Markets areclassified into two kinds:

i. Equity Market

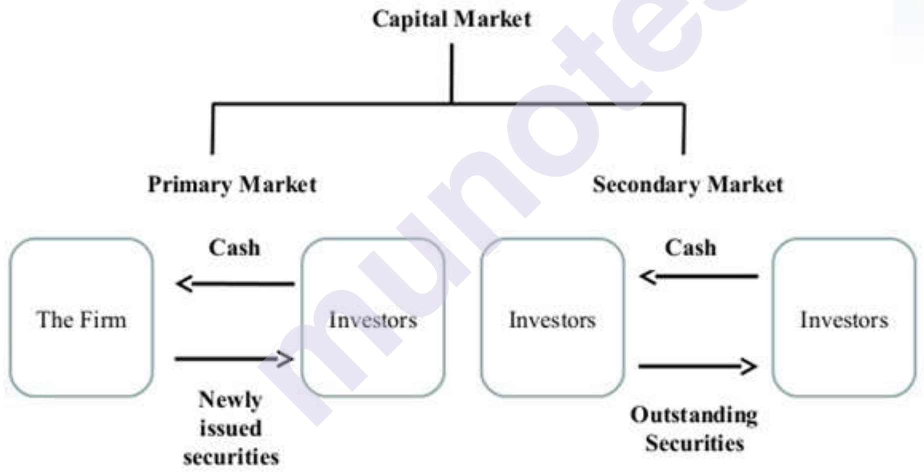
ii. Debt Market



Recently there has been a substantial development of theIndian Capital Market. It comprises various sub-markets.

Equity market is more popular in India. It refers to the market for equityshares of existing and new companies. Every company shall approach the market for rising of funds.

The equity market can bedivided into two categories:



1. Primary Market

2. Secondary Market.

Debt Market represents the market for long-term financialinstruments such as debentures, bonds etc.

5.10.5 : INDUSTRIAL SECURITIES

A] Industrial Securities Market :

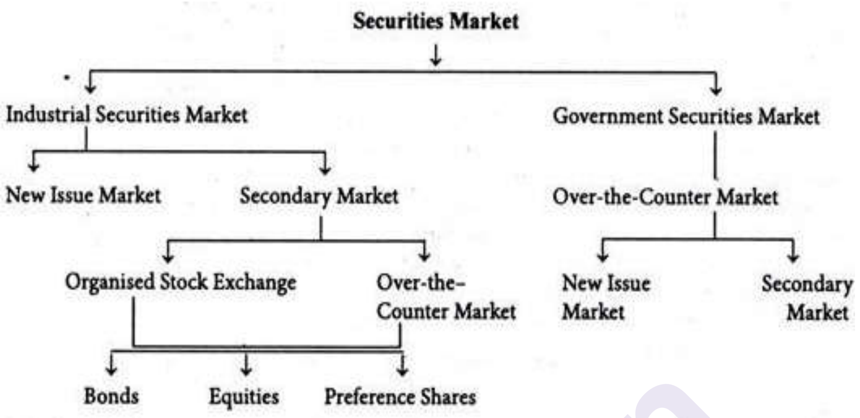
As the very name suggests, it is a market for industrialsecurities namely:

1. Equity shares or ordinary shares

2. Preference Shares

3. Debentures or bonds.

It is a market where industrial concernsraise their capital or debt by issuing appropriate instruments.



It can be further divided into :

A. Primary Market or New Issue Market

B. Secondary Market or Stock Exchange.

A) Primary Market :

Primary Market is a market for new issues or new financialclaims. Hence, it is also called New Issue Market. The primarymarket deals with these securities which are issued to the public forthe first time.

There are three ways by which a company may raisecapital in a primary market.

They are:

i. Public issue

ii. Rights issue

iii. Private Placement

The most common method of raising by new companies isthrough sale of securities to the public. It is called public issue.

When an existing company wants to raise additional capital,securities are first offered to the existing shareholders on a pre-emptivebasis. It is called rights issue. Private placement is a wayof selling securities privately to a small group of investors.

B) Secondary Market :

Secondary Market is a market for secondary sale ofsecurities. In other words, securities which have already passedthrough the new issue market are traded in this market.

Generally,such securities are quoted in the Stock Exchange and it provides acontinuous and regular market for buying and selling of securities.This market consists of all stock exchanges recognised by theGovernment of India. The stock exchanges in India are regulatedunder the Securities Contracts (Regulation) Act, 1956. The Bombay

Stock Exchange is the principal stock exchange in India which setsthe tone of the other stock markets.

Secondary Market, also known as the aftermarket, is theplace where goods which are already used by someone are soldand/or bought. Thus we can define secondary market as "thefinancial market where previously issued securities and financialinstruments such as stocks, bonds, futures and options aremanoeuvred from one investor into another." Secondary marketprimarily deals with used products or an alternative use of anexisting product or assets where the customer base is the secondmarket.

For example, rice is primarily known as food item so thefood market is the first or primary market for rice. Broken rice is theby-product in rice mills and is used for producing liquid glucose.About 90% of liquid glucose produced in India is used inconfectionary industry. Thus it can be said that confectionaryindustry is the secondary market for rice which is in the form ofliquid glucose.

Secondary Market can be divided into three parts. These are:

I. Equity Market

II. Debt Market

III. Derivative Segment

I) Equity Market :

Shares of a company which are also termed as equities make the person or organisation holding them as the shareholderof the company. Most of the investors prefer to invest in thembecause equities have the proven track record of outperformingother forms of the investments. The value of most of the equities tends to increase over a period of time.

Dividend is a percentage of theface value of a share that a company returns to the shareholdersfrom its annual profits.

Indian Equity Markets depend mainly on monsoons, globalfunds flowing into equities and the performance of variouscompanies. Indian Equity Market is almost majorly dominated bythe two oldest and biggest stock exchanges of the country. These are BSE and NSE. The benchmark indices of the two exchangesare Nifty for NSE and Sensex for BSE are closely followed.

II) Debt Market :

Debt Market is that part of secondary market whereinvestors buy and sell debt securities which are mostly in the formof bonds. It is the market where fixed income securities are issuedand traded. For a developing economy like India, debt markets arecrucial source of capital funds. Indian Debt Market is almost thirdlargest in the world and one of the largest in Asia. It includes government securities, public sector undertakings, othergovernment bodies, financial institutions, banks and companies.

Total size of the Indian Debt Market is in the range of $92 billion to$100billion i.e. approximately 30% of GDP.

A] **Classification of the Indian Debt Market :**

Indian Debt Market can be broadly classified in two categories:

1. Government Securities Market
2. Bond Market

1) Government Securities Market :

In G-sec (Government Securities) market securities are issued by the Governments ofthe state and centre for the purpose of taking loans.

2) Bond Market :

Bond Market link issuers, i.e. governments, state ownedinstitutions, local bodies and corporate having financing needs, withthe investors having investible funds. In an efficient bond marketrequirements of both the issuers and investors are met effectivelyat a price (interest rates) determined competitively and priceadjustment to some new information is seamless.

Bond Market consists of the following:

i. Corporate Bonds
ii. Public Sector Unit Bonds
iii. Banks and Financial Institutions Bonds

i) Corporate Bonds and Debentures :

Have maturities beyond 1 year and generally up to 10 years. Corporate also issue short term commercial paper with maturityranging from 15 days to 1 year.

ii) Public Sector Unit Bonds :

PSU Bonds are generally treated as surrogates of sovereignpaper, sometimes due to explicit guarantee of Government, andoften due to comfort of public ownership. As compared to G-Secs,corporate bonds carry higher risks, which depend upon thecorporation, the industry where the corporation is currentlyoperating, the current market conditions and the rating of thecorporation.

iii) Banks and Financial Institutions Bonds :

Most of the institutional bonds are in the form of promissorynotes transferable by endorsement and delivery. They arenegotiable certificates issued by the Financial Institutions such asthe IDBI/ICICI/IFCI or by the commercial banks. These instruments have been issued both the regular income bonds and asdiscounted long term instruments (deep discount bonds).

B] Participants in Debt Market :

Given the large size of trades, Debt Market is predominantlya wholesale market, with dominant institutional investorparticipation. The investors in debt market are mainly banks, financial institutions, mutual funds, provident funds, insurance companies and corporate.

In order to understand the participants and products dealt indebt market following table can be studied.

Issuer	Instrument	Maturity	Major Investors
Central Government	Dated Securities Treasury Bills	2-30 years 91/364 days	RBI, Banks, Insurance Companies, Provident Funds, PDs, Individuals.
State Government	Dated Securities	5-10 years	Banks, Insurance Companies, Provident Funds
PSUs	Bonds	5-10 years	Banks, Insurance Companies, Corporate, Provident Funds, Mutual Funds, Individuals
Corporate Debentures PDs	Bonds and Commercial Paper Commercial Paper	1-12 year 15 days to 1 year	Banks, Mutual Funds, Individual Banks, Corporate, Financial year Institutions, Mutual Funds, Individuals.
Banks	Bonds issued of tier II Capital Certificates of Deposits	Minimum 5 years 3 months to 1 year	Banks, Corporate

III) Derivative Segment :

Financial markets are well known for their volatile nature andhence risk factor is an important factor for financial agents. Toreduce this concept of derivatives comes into picture. Derivativesare product whose values are derived from one or more basicvariables called bases. These bases can be underlying assets (forexample FOREX, equity etc.) bases or reference rates. For examplerice farmers may be willing to sell their harvest at a future date toeliminate risk of changes in the price by that date. The transactionin this case will be called derivative, while spot price of the wheatwould be underlying assets. Derivatives were introduced in theIndian Stock Market to enable the investors to hedge theirinstruments against adverse volatile price movements. However, they are now commonly being used for taking speculative positions.

A] Classification of the Derivative Market :

Derivatives Market can broadly be classified in twocategories, those that are traded on the exchange and those thatare traded one to one or 'over the counter'.

They are hence known as :

i. Exchange traded derivatives
ii. OTC Derivatives (Over The Counter)

i) Exchange traded Derivatives :

They are the most common and popular kind of derivativestraded normally on the exchanges.

ii) OTC Equity Derivatives :

They have long history in India in OTC Market. Options ofvarious kinds were available (called Teji, Mandi and Fatak) in unorganized markets and were traded in Mumbai as early as 1900.

However, SCRA banned all kind of option in 1956 and this can waslifted in 1995.

B] Participants in Derivatives Market :

(a) Hedgers – They use futures or option markets to reduce oreliminate the risk associated with price of assets.

(b) Speculators - They use futures and options contract to get extraleverage in betting on future (b) movements in price of an asset. Theycan increase both the potential gains and potential losses by usageof derivatives in a speculative venture.

(c) Arbitrageurs – Theseare in business to take advantage of adiscrepancy between prices in two different markets. If, for exampleif they forecast that future price of an asset is getting out of line withthe cash price, they will take offsetting positions in the two marketsto lock in profit.

C] **Types of Derivatives :**

i) Forwards :

A forward contract is customised contract between twoentities, where settlement takes place on a specific date in futureon today's pre-agreed price.

ii) Futures :

A future contract is an agreement between two parties to buyor sell an asset at a certain time in future at a certain price. Theyare special kind of forwards contracts in the sense that former arestandardised exchange traded contracts.

iii) Options :

Options are of two types - calls and put option. Call optiongives the buyer the right but not the obligation to buy a givenquantity of the underlying asset, at a given price on or before agiven future date. On the other the put option gives the buyer theright, but not the obligation to sell a given quantity of the underlyingasset at a given price on or before a given future date.

iv) Warrants :

Options generally have life of one year, the majority ofoptions traded on options exchange having a maximum maturity of nine months. Longer dated options are called warrants and aregenerally traded over the counter.

v) LEAPS :

Long term Equity Anticipation Securities are options havingmaturity of 3 years.

vi) Baskets :

Baskets options are options on portfolios of underlying asset.The underlying asset is usually a moving average or a basket ofasset. Equity index options are form of basket options.

vii) Swaps :

Swaps are private agreements between two parties toexchange cash flows in the future according to a prearrangedformula. They can be regarded as portfolios of forward contracts.

The two most commonly used swaps are:

(a) Interest Rate Swaps :

They involve swapping only interest related cash flowsbetween the parties in the same currency.

(b) Currency Swaps :

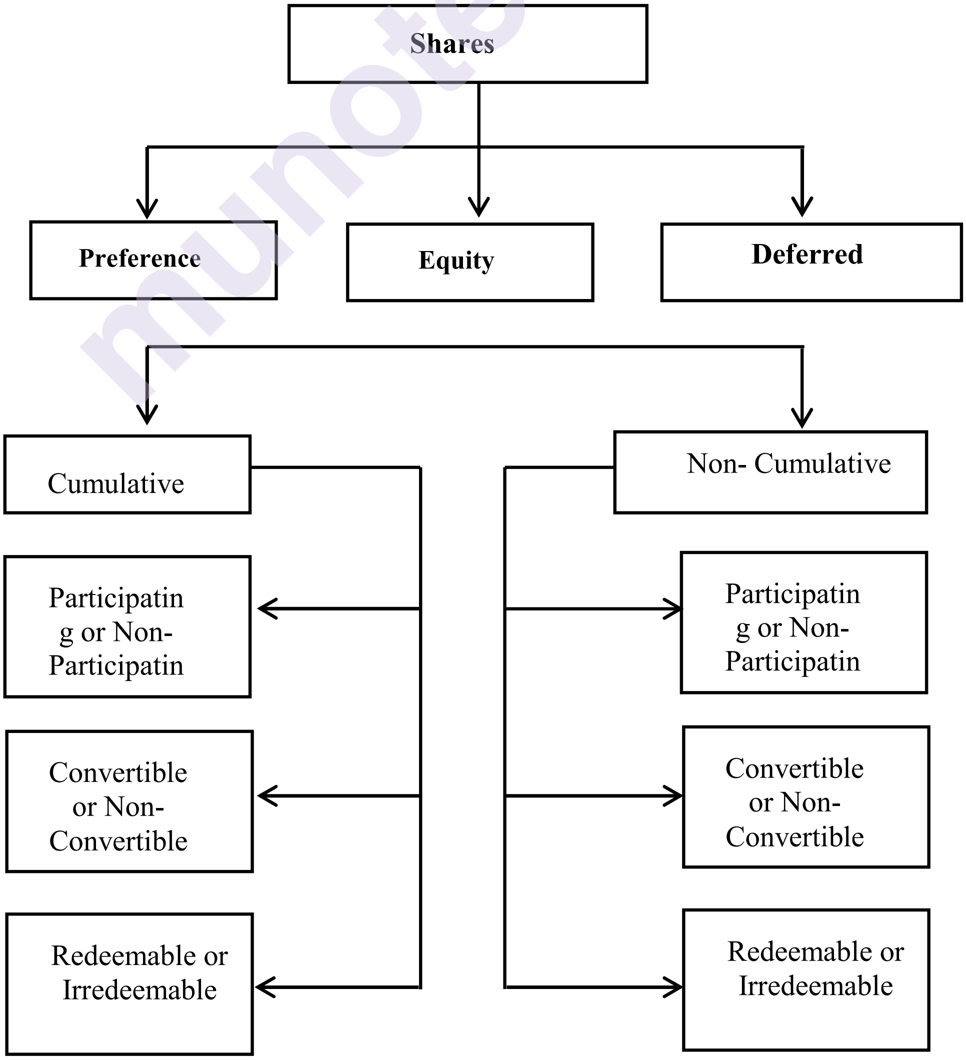
They involve swapping of both the principal and interestbetween the parties, with cash flows in one direction being in adifferent currency than those in the opposite direction.

viii) Swaptions :

Swaptions are options to buy or sell a swap that will becomeoperative at the expiry of the option. Thus, it can be said thatSwaption, is an option on a forward swap. Rather than having callsand puts, the swaptions market has receiver swaptions and payerswaptions. A receiver swaption is an option to receive fixed and payfloating, on the other a payer swaptions is an option to pay fixedand receive floating.

5.10.6 : INSTRUMENTS OF SECONDARY MARKET

A] Classification of Shares :



Following are the main instruments or products dealt in SecondaryMarket:

1. Shares
2. Debentures
3. Bonds
4. Mutual Funds

1) Shares :

"A share in the share capital of the company and includes stock except where a distinction between stock and share isexpressed or implied." For example, if the capital of the company is 10, 000 and is divided into 1000 units of 10/- each then eachunit of 10/- shall be called share of the company.

Chart of Classification of Shares is depicted on the earlier page.

2) Debentures :

A debenture is a unit of loan amount. When a company intends to raise the loan amount from the public it issuesdebentures and the person holding debenture or debentures iscalled the debenture holder. A debenture holder is the creditor ofthe company. Debentures bear a fixed rate of interest on them andthe same is paid on some pre specified date on half yearly basis.

The bond amount is paid on a particular date on the redemption ofthe bond. Debentures are normally secured against the assets ofthe company in the favour of the debenture holder.

As per Section 2(12) of Companies Act 1956, "Debenture includes debenture stock, bond and any other securities of thecompany whether constituting a charge on the company's assets ornot."

3) Bonds :

Bond is a negotiable certificate evidencing indebtness. It isnormally unsecured. A debt security is generally issued by acompany, government agency or municipality.

4) Mutual Funds :

Mutual Fund can be described as a common pool of moneywhere many small and retail investors put in their money. Thismoney is allocated towards some objective which is predefined.

Thus it can be said that ownership of the fund is joint or mutual, asthis belongs to all those investors who have contributed to it.

Ownership of an investor is in same proportion as the contributionmade by him bears toot the total pool (amount) of the fund created.

You would have learnt the ‘Capital Market’ in detail in Module no. 2 : ‘Financial Markets’ of the subject : Foundation Course in Commerce (Financial Market Operations) – III in semester III of your course.

5.11 FUNCTIONS OF CAPITAL MARKET

Capital Market plays a vital role in the development bymobilizing the savings to the needy corporate sector. In recentyears there has been a substantial growth in the Capital Market.

The Capital Market involves in various functions and significance.

They are as below:

i. Co-ordinator

ii. Motivation to savings

iii. Transformation to investments

iv. Enhances economic growth

v. Stability

vi. Advantages to the investors

vii. Barometer

i) Co-ordinator :

The Capital Market functions as coordinator between saversand investors. It mobilizes the savings from those who have surplusfund and divert them to the needy persons or organizations.

Therefore, it acts as a facilitator of the financial resource. In thisway it plays a vital role in transferring the surplus resources todeficit sectors. It increases the productivity of the industry whichultimately reflects in GDP and national income of the country. It increases the prosperity of the nation.

ii) Motivation of Savings :

The Capital Market provides a wide range of financialinstruments at all times. India has a vast number of individualsavers and the crores of rupees are available with them. Theseresources can be attracted by the Capital Market with nature. Thebanks and non-banking financial institutions motivate the people tosave more and more. In less developed countries, there is noefficient Capital Market to tap the savings. In underdevelopedcountries there are very little savings due to various factors. Inthose countries they invest mostly in unproductive sector.

iii) Transformation of Investment :

The Capital Market is a place where the savings aremobilized from various sources, is at the disposal of businessmen and the government. It facilitates lending to the corporate sectorand the government. It diverts the savings amount towards capitalformation of the corporate sector. It creates assets by helping theindustry. Thus, it enhances the productivity and leads toindustrialization. The industrial development of the country depends upon the dynamic nature of the Capital Market. It also provides facilities through banks and non-banking financial institutions. Thedevelopment of financial institutions made the way easy to capitalmarket. The capital has become more mobile. The interest rate fall lead to an increase in the investment.

iv) Enhances economic growth :

The development of the Capital Market is influenced bymany factors like the level of savings with the public, per capitaincome, purchasing capacity, and the general condition of theeconomy. The Capital Market smoothens and accelerates theprocess of economic growth.

The Capital Market consists of variousinstitutions like banking and non-banking financial institutions. It allocates the resources very cautiously in accordance with thedevelopment of needs of the country. The balanced and properallocation of the financial resources leads to the expansion of theindustrial sector. Therefore, it promotes the balances regionaldevelopment. All regions should be developed in the country.

v) Stability :

The Capital Market provides a stable security prices in thestock market. It tends to stabilize the value of stocks and securities.It reduces the fluctuations in the prices to the minimum level. Theprocess of stabilization is facilitated by providing funds to theborrowers at a lower interest rate. The speculative prices in thestock market can be reduced by supply of funds. The flow of fundstowards secondary market reduces the prices at certain level.

Therefore, the Capital Market provides funds to the stock market ata low rate of interest.

vi) Advantages to the Investors :

The investors who have surplus funds can invest in long-termfinancial instruments. In Capital Market, a number of long-termfinancial instruments are available to the investor at any time.

Hence, the investors can lend their money in the Capital Market atreasonable rate of interest. The Capital Market helps the investorsin many ways. It is the coordinator to bring the buyer and seller atone place and ensure the marketability of investments. The stockmarket prices are published in newspapers everyday which enablesthe investor to keep track of their investments and channelize theminto most profitable way. The Capital Market safeguards the interestof the investors by compensating from the stock exchangecompensating fund in case of fraud and default.

vii) Barometer:

The development of the Capital Market is the indicator of thedevelopment of a nation. The prosperity and wealth of a nation depends, upon the dynamic Capital Market. It not only reflects thegeneral condition of the economy but also smoothen andaccelerates the process of economic growth. It consists a numberof institutions, allocates the resources rationally in accordance withthe development needs of the country. A good allocation ofresources leads to expansion of trade and industry. It helps bothpublic and private sector.

5.12 FUNDAMENTAL ANALYSIS

A] Introduction :

The intrinsic value of an equity share depends on a multitude of factors. The earningsof the company, the growth rate and the risk exposure of the company have a direct bearingon the price of the share. These factors in turn rely on the host of other factors like economicenvironment in which they function, the industry they belong to, and finally companies'own performance.

The fundamental school of thought appraised the intrinsic value of shares through

1. Economic Analysis
2. Industry Analysis
3. Company Analysis

B] Economy-Industry-Company Analysis Framework :

The analysis of economy, industry and company fundamentals constitute the mainactivity in the fundamental approach to security analysis. In this era of globalization wemay add one more circle to the diagram to represent the international economy.

The logic of this three tier analysis is that the company performance depends notonly on its own efforts, but also on the general industry and economy factors. A companybelongs to an industry and the industry operates within the economy. As such, industry andeconomy factors affect the performance of the company.

The multitude of factors affecting the performance of a company can be broadlyclassified as:

(1) Economy-wide factors - Such as growth rate of the economy, inflation rate, foreignexchange rates, etc. which affect all companies.

(2) Industry-wide factors - Such as demand-supply gap in the industry, the emergence ofsubstitute products, changes in government policy relating to the industry, etc. thesefactors such as the age of its plant, the quality of management.

(3) Company specific factors - Such as the age of its plant, the quality of managementbrand image of its products, its labour-management relations, etc. these factors arelikely to make a company's performance quite different from that of its competitorsin the same industry.

Fundamental analysis thus involves three steps:

I. Economy Analysis

II. Industry Analysis

III. Company analysis

Let us see what each of these analyses implies.

I) Economy Analysis :

The performance of a company depends on the performance of the economy. If theeconomy is booming, incomes rise, demand for goods increases, and hence the industriesand companies in general tend to the prosperous. On the other hand, if the economy is inrecession, the performance of companies will be generally bad.

Investors are concerned with those variables in the economy which affect theperformance of the company in which they intend to invest. A study of these economicvariables would give an idea about future corporate earnings and the payment of dividendsand interest part of his fundamental analysis.:

1. Growth Rates of National Income
2. Inflation
3. Interest Rates
4. Government Revenue, Expenditure and Deficits
5. Exchange Rates
6. Infrastructure
7. Monsoon
8. Economic and Political Stability

9. Economic Forecasting
10. Forecasting Techniques
11. Anticipatory Surveys
12. Barometric or Indicator Approach
13. The US Department of Commerce, through its Bureau of Economic Analysis, hasprepared a short list of the different indicators. Some of them are given below for illustrative purpose.

i. **Leading Indicators**

ii. **Coincidental Indicators**

iii. **Lagging Indicators**

Of the three types of indicators, leading indicators are more useful for economicforecasting because they measure something that foreshadows a change in economic activity.

II) Industry Analysis :

An industry is a group of firms that have similar technological structure ofproduction and produce similar products. For the convenience of the investors, the broadclassification of the industry is given in financial dailies and magazines. Companies aredistinctly classified to give a clear picture about their manufacturing process and products.

The table gives the industry wise classification given in Reserve Bank of India Bulletin.

Industry Groups :

Industries	
S/N	**Type of industry**
1	Food Products
2	Beverages, Tobacco and Tobacco products
3	Textiles
4	Wood and wood products
5	Leather and leather products
6	Rubber and plastic products
7	Chemical and chemical products
8	Non-metallic mineral products
9	Basic metals, alloys and metal products
10	Machinery and Machine tools
11	Transport equipment and parts
12	Other Miscellaneous manufacturing industries

The table shows that each industry is different from the other. Textile industry is entirely different from the steel industry or the power industry in its product and process.

These industries can be classified on the basis of the business cycle i.e., classifiedaccording reactions to the different phases of the business cycle.

They are classified into :

a) Growth,
b) Cyclical,
c) Defensive and
d) Cyclical Growth Industry.

A] Industry Life Cycle :

The industry life cycle theory is generally attributed to Julius Grodensky. The lifecycle of the industry is separated into four well defined stages such as :

- Pioneering stage
- Rapid growth stage
- Maturity and stabilization stage
- Declining stage

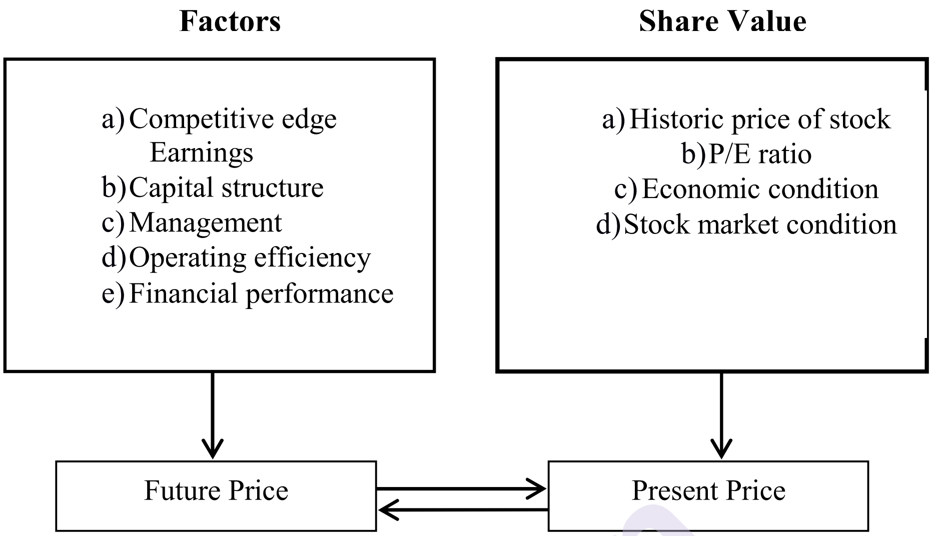
Apart from industry life cycle analysis, the investor has to analyse some other factors too. They are as listed below

- Growth of the industry
- Cost structure and profitability
- Nature of the product
- Demand for the Product
- Nature of the competition
- Government policy
- Labour rules
- Research and development
- Strength, Weakness, Opportunity & Threat

III) Company analysis :

In the company analysis the investor assimilates the several bits of informationrelated to the company and evaluates the present and future values of the stock. The riskand return associated with the purchase of the stock is analysed to take better investmentdecisions. The valuation process depends upon the investors' ability to elicit informationfrom the relationship and inter-relationship among the company related variables.

The present and future values are affected by a number of factors and they are given in figure below:



The Competitive edge of the company

a) The Competitive Edge of the Company :

Major industries in India are composed of hundreds of individual companies. Thein the information technology industry even though the number of companies is large,few companies like Tata InfoTech, Satyam computers, Infosys, NIIT etc., control the majormarket share. Like-wise in all industries, some companies rise to the position of eminenceand dominance. The large companies are successful in meeting the competition. Once thecompanies obtain the leadership position in the market, they seldom lose it. Over the timethey would have proved their ability to withstand competition and to have a sizeable sharein the market.

The competitiveness of the company can be studied with the help of :

- The market share
- The growth of annual sales
- The stability of annual sales
- Sales Forecast
- Earnings of the Company

The investor should be aware that income of the company may vary due to thefollowing reasons.

- Change in sales
- Change in costs
- Depreciation method adopted
- Depletion of resources in the case of oil, mining, forest products, gas etc.
- Inventory accounting method
- Replacement cost of inventories

- Wages, salaries and fringe benefits
- Income taxes and other taxes.

b) Capital Structure :

The equity holders' return can be increased manifold with the help of financialleverage, i.e., using debt financing along with equity financing. The effect of financialleverage is measured by computing leverage ratios. The debt ratio indicates the position ofthe long term and short term debts in the company finance. The debt may be in the form ofdebentures and term loans from financial institutions.

- **Preference Shares**
- **Debt**
    i) **Earnings Limit of Debt**
    ii) **Assets Limit to Debt**

c) Management :

Good and capable management generates profit to the investors. The managementof the firm should efficiently plan, organize, actuate and control the activities of thecompany. The basic objective of management is to attain the stated objectives of companyare achieved, investors will have a profit.

d) Operating Efficiency :

The operating efficiency of a company directly affects the earnings of a company. Anexpanding company that maintains high operating efficiency with a low break-even pointearns more than the company with high break-even point. If a firm has stable operatingratio, the revenues also would be stable.

Efficient use of fixed assets with raw materials, labour and management would leadto more income from sales. This leads to internal fund generation for the expansion of thefirm. A growing company should have low operating ratio to meet the growing demand forits product.

e) Financial performance :

The best source to understand the financial performance of a company is through its own financial statements. This is a primary source of information for evaluating the investment prospects in the particular company's stock.

Financial statement analysis is the study of a company's financial statement from various viewpoints. The statement gives the historical and current information about the company's operations.

Historical financial statement helps to predict the future. The current information aids to analyse the present status of the company.

The two main statements used in the analysis are:

i. Balance sheet
ii. Profit and loss account

(i) The Balance Sheet :

The balance sheet shows all the company's sources of funds (liabilities andstockholders' equity) and uses of funds at a given point of time.

(ii) The Profit and Loss Account :

Analysis of the financial condition of the company requires a report on the flow offunds too. The income statement reports the flow of funds from business operations that take place in between two points of time. It lists down the items of income and expenditure.

The difference between the income and expenditure represents profit or loss for the period.

It is also called income and expenditure statement.

f) Analysis of Financial Statement :

The analysis of financial statements reveals the nature of relationship betweenincome and expenditure, and the sources and application of funds. The investor determines the financial position and the progress of the company through analysis. The investor is interested in the yield and safety of his capital. He cares much about the profitability andthe management's policy regarding the dividend.

For that he can use the following simple analysis :

- Comparative financial statements
- Trend analysis
- Common size statements
- Fund flow analysis
- Cash flow analysis
- Ratio analysis

5.13 TECHNICAL ANALYSIS

5.13.1 : INTRODUCTION

Technical analysis concentrates on demand andsupply of securities and prevalent trend in share price mean byvarious market indices in the stock market.

The technical analysis is based on the doctrine given byCharles H. Dow in 1884, in the Wall Street Journal. He wrote aseries of articles in the Wall Street Journal A.J. Nelson, a closefriend of Charles Dow formalized the Dow Theory for economicforecasting. The analysts used charts of individual stocks and moving averages in the early1920's. Later on, with the aid ofcalculators and computers, sophisticated techniques came intotrend.

It is a process of identifying trend reversals at an earlierstage to formulate the buying and selling strategy. With the help ofseveral indicators they analysed the relationship between price -volume and supply-demand for the overall market and theindividual stock. Volume is favourable on the upswing i.e. thenumber of shares traded is greater than before and on thedownside the number of shares traded dwindles If it is the otherway round, trend reversals can be expected.

5.13.2 : DIFFERENT CHARTING TECHNIQUES

1) Line Charts :

The most basic of the four charts is the line chart because itrepresents only the closing prices over a set period of time. The lineis formed by connecting the closing prices over the time frame.

2) Bar Charts :

Bar Charts are one of the most popular forms of stockcharts and were the most widely used charts before the introductionof candlestick charts. Bar charts are drawn on a graph that plotstime on the horizontal axis and price levels on the vertical axis.

These charts provide much more information than line charts asthey consists of a series of vertical barsthat indicate various price data for eachtime-frame on the chart.

This data can be either the open price, the high price, thelow price and the close price, making it an OHLC bar chart, or the high price, the low price and the closeprice, making it an HLC bar chart.

3) Japanese Candlestick Charts :

Japanese candlestick charts form the basis of the oldestform of technical analysis. They were developed in the 17th centuryby a Japanese rice trader named Homma and was introduced tothe rest of the world in Steve Nison's book, Japanese CandlestickCharting Techniques. Candlestick charts provide the sameinformation as OHLC bar charts, namely open price, high price, lowprice and close price, however, candlestick charting also provide avisual indication of market psychology, market sentiment, andpotential weakness, making it a rather valuable trading tool.

4) Point and Figure (P&F) Charts :

Point and Figure (P&F) charts date back to at least 1880'sand differ from other charts as it does not plot price movement fromleft to right within fixed time intervals. It also does not plot thevolume traded. Instead it plots unidirectional price movements inone vertical column and moves to the next column when the pricechanges direction.

5.13.3: DIFFERENT CHART PATTERNS

The two basic elements of technical analysis and the studyof chart patterns in particular, are the concepts of support andresistance and trend lines. It is based on support and resistance and states that amarket is in an uptrend when it makes higher highs and higherlows, and is in a downtrend when it makes lower lows and lowerhighs.

I) Support and Resistance (S/R) Lines :

Support and Resistance lines are often confusedwith trend lines.

However, supportand resistancelines are horizontallines drawn underthe minor lows andabove the highsrespectively. Theyindicate where previous rally met resistances that drove the price back down andwhere a previous decline met support that pushed the price backup.

II) Trend Lines :

Trend lines are key elements of chart patterns as theyindicate significant price levels. Thus an understanding of trend lines and what they represent are important for successfultechnical analysis.

III) Head and Shoulders :

The Head andShoulders patternis one of the mostreliable trendreversal patternsand is usuallyseen in uptrends, where it is alsoreferred to asHead andShoulders Top, though they canappear in downtrends as well, where they are also referred to asHead and Shoulders Bottom or Inverse Head and Shoulders. Asthey are trend reversal patterns, the Head and Shoulders patternsrequires the presence of an existing trend.

IV) Double Top and Double Bottom Patterns :

The double tops and double bottoms patterns are tworelated chart patterns that are some of the easiest trend reversalpatterns to identify that appear on line, bar, candlestick charts, andPoint-and-Figure charts.

V) Triangles :

(i) Ascending Triangles :

The ascending trianglepattern is similar to thesymmetrical triangleexcept that its upper trendline is a horizontalresistance line. Ascendingtriangles are generallybullish in nature and aremost reliable when theyappear as a continuationpattern in an uptrend. Inthese patterns, buyersslightly outnumber sellers.

(ii) Descending Triangles :

The descending triangle pattern is similar to the symmetrical triangle except that its lower trend line forms a horizontal support line.

VI) Flag Pattern :

The flag pattern is one of the short-term continuationpatterns. It is quite similar to the pennant pattern with the "flag"representing a relatively short consolidation period following asharp price movement and marks the mid-point of a longer pricemovement. It is not a reversal pattern.

You will learn the 'Fundamental Analysis', 'Technical Analysis', etc. in detail in Modules no. 3 & 4 : 'Fundamental Analysis' and 'Technical Analysis' resp. of the subject : Security Analysis and Portfolio Management in semester VI of your course.

5.14 VENTURE CAPITAL

5.14.1 : INTRODUCTION

Generally, the corporate sector requires funds not only formeeting their long-term requirements of funds for their new projectsmodernization, expansion and diversification programme but alsofor covering their operational needs.

Therefore, their requirement ofcapital is classified as given below:

a. Long-term capital

b. Short-term capital

c. Venture capital

d. Export capital

Venture capital is the capital which is invested in highly riskyventures. It is also known as seed capital. It is a quite recententrant in the Capital Market. It has great significance in helpingtechnocrat entrepreneurs at the commencement stage of theconcern. It has technical expertise. But it lacks finance.

Venture capital is a funding or capital generation process in which the venture funding companies manage the funds of the investors who want to invest in new businesses which have the potential for high growth in future. The venture capital funding firms provide the funds to start ups in exchange for the equity stake. Such a startup is generally one that possesses the ability to generate high returns. However, the risk for venture capitalists is high.

5.14.2 : STAGES OF VENTURE FUNDING

There are five stages of venture funding as follows :

Stage 1 - Seed Capital

Stage 2 - Startup Capital

Stage 3 - Early Stage / Second Stage Capital

Stage 4 - Expansion Stage

Stage 5 - Bridge / Pre IPO Stage

Stage 1 - Seed Capital :

In this first stage of venture funding, the venture or the startup company in need of the funds contacts the venture capital firm or the investor. The venture firm shall share its idea of business with the investors and convince them to invest in the project. The investor or venture capital firm shall then conduct research on the business idea and analyze its future potential. If the expected returns in future are good, the investor (Venture capitalist) shall invest in the business.

Stage 2 - Startup Capital :

Startup capital is the second stage of venture funding. If the venture is able to attract the investor, the idea of the business of the venture is brought into reality. A prototype product is developed and fully tested to know the actual potential of the product. Generally, a person from the venture capital firm takes a seat in the management of the business to monitor the operations regularly and keep a check that every activity is done as per the framed plan. If the idea of business meets the requirement of the investor and has sufficient market in the trail run, the investor agrees to participate in the future course of the business.

Stage 3 - Early Stage / Second Stage Capital :

After the startup capital stage comes the early/first/second stage capital. In this stage, the investor significantly increases the capital invested in the venture business. The capital increase is mainly towards increasing the production of goods, marketing or other expansion say building a network etc. The company with higher capital inflow moves towards profitability as it is able to reach a wide range of customers.

Stage 4 - Expansion Stage :

This is the fourth stage of venture funding. In this stage, the company expands its business by way of diversification and differentiation of its products. This is possible only if the company is earning good profits and revenue. To reach up to this stage the company needs to be operational for at least 2 to 3 years. The expansion gives the venture new wings to enter into untapped markets.

Stage 5 - Bridge / Pre IPO Stage :

This is the last stage of venture funding. When the company has developed substantial share in the market with its products, the company may opt for going public. One main reason for going public is that the investors can exit out of the company after earning profits for the risks they have taken all the years. The company mainly uses the amount received by way of IPO for various purposes like merger, elimination of competitors, research and development, etc.

You would have learnt ‘Venture Capital’ in detail in Module no. 3 : ‘Financial Services and its Mechanism’ of the subject : Innovative Financial Services in semester II of your course.

5.15 DEMAT ACCOUNT

5.15.1 : INTRODUCTION

A Demat Account is a bit like a bank account for your share certificates and other securities that are held in an electronic format. Demat Account is short for dematerialisation account and makes the process of holding investments like shares, bonds, government securities, Mutual Funds, Insurance and ETFs easier, doing away the hassles of physical handling and maintenance of paper shares and related documents.

The Demat full form stands for a Dematerialised Account. Demat is a form of an online portfolio that holds a customer's shares and other securities. It has negated the necessity of holding and trading physical share certificates.

Today, there's no paperwork involved, and physical certificates are no longer issued. So when you buy shares of Company X, all you get is an entry in electronic form, in your Demat Account. So this is what a Demat Account is.

A Demat account is used to hold shares and securities in an electronic (dematerialised) format. These accounts can also be used to create a portfolio of one's bonds, ETFs, mutual funds, and similar stock market assets.

Demat trading was first introduced in India in 1996 for NSE transactions. As per SEBI regulations, all shares and debentures of listed companies have to be dematerialised in order to carry out transactions in any stock exchange from 31st March 2019.

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5.15.2 : FEATURES OF DEMAT ACCOUNT

Some of the key features to understand Demat account are as follows :

i) Easy Access :

It provides quick & easy access to all your investments and statements through net banking.

ii) Easy Dematerialization of Securities :

The depository participant (DP) helps to convert all your physical certificates to electronic form and vice versa.

iii) Receiving Stock Dividends & Benefits :

It uses quick & easy methods to receive dividends, interest or refunds. It is all auto-credited in the account. It also uses Electronic Clearing Service (ECS) for updating investors' accounts with stock splits, bonus issues, rights, public issues, etc.

iv) Easy Share Transfers :

Transfer of shares has become much easier and time-saving with the use of a Demat account.

v) Liquidity of Shares :

Demat Accounts have made it simpler, faster and more convenient to get money by selling shares.

vi) Loan Against Securities :

After opening a Demat account, one can also avail of a loan against the securities held in your account.

vii) Freezing Demat Account :

One can freeze a certain amount or type of their Demat account securities for a certain period of time. This eventually will stop the transfer of money from any debit or credit card into your account.

5.15.3 : BENEFITS OF A DEMAT ACCOUNT

There are various benefits of opening a Demat Account and they are as follows:

i) No requirement of paper certificates :

Prior to the existence of Demat Accounts, share used to exist as physical paper certificates. Once you purchased shares, you had to store several paper certificates for the same. Such copies were vulnerable to loss and damage, and also come attached with lengthy transfer processes. Demat Account turned all of it electronic, saving you much hassle.

ii) Ease of Storage :

With a Demat Account you can store as many shares as you need to. This way, you can trade in volumes and keep track of the shares in your account. You can also rely on your Demat Account to execute quick transfer of shares.

iii) Varietyof Instruments:

Apart from stock market shares, you can also use your Demat Account to hold multiple assets including mutual funds, Exchange Traded Funds (ETFs), government securities, etc. Thus, with a Demat Account, you can approach your investment plans more holistically and easily build a diverse portfolio.

iv) Easy Access:

Accessing your Demat Account is super easy. You can do so with the help of a smartphone or laptop and manage your investments from anywhere, at any time. A Demat Account truly makes investing for a financially secure future more easy and accessible than it has ever been before.

v) Nomination:

A Demat Account also comes with a nomination facility. The process of nomination is to be followed as has been prescribed by the depository. In case the investor passes away, the appointed nominee receives the shareholding in the account. This feature enables you to make plans for future eventualities and avoid legal disputes.

5.15.4 : DEMAT AND TRADING ACCOUNTS

A Demat Account is usually accompanied by a Trading Account, which is required for buying and selling shares on the stock market. HDFC Bank, for example, has a 3 in 1 Account that combines bank accounts like a Savings Account, a Demat Account and a Trading Account.

Sometimes, people are confused between Demat and Trading Accounts. They are not the same. A Demat Account contains the details of the shares and other securities in your name. To purchase and sell shares, you need to open a Trading Account. Many banks and brokers offer Trading Accounts with online trading facilities, which make it easier for ordinary investors to participate in the stock market.

5.15.5 : WORKING OFDEMAT ACCOUNTS DURING TRADING

In general, Demat Accounts are used to hold the purchased shares by an individual-

- If a person intends to buy or sell a certain company's share, the first step is to log in to the Demat and Trading Account that is linked to the bank's account.
- When he/she places a 'Buy/Sell' request in a trading account, the DP forwards the same to the stock exchange immediately.
- Let's assume a 'Buy' order was placed. The stock exchange will run a search for a seller who intends to sell his/her shares. If the price matches, it will be taken forward to the clearance houses to get it debited from the seller's Demat and credited to the buyer's materialized account.

A significant thing to note here is that the buyer and seller may hold a Demat account with DPs associated with different depositories.

5.15.6 : DEMAT ACCOUNT NUMBER AND DP ID

Demat Account number - It is known as 'beneficiary ID' if under CDSL. It is a mix of 16 characters.

DP ID - The ID is given to the depository participant. This ID makes a part of your Demat Account number.

POA number - This is part of the Power of Attorney agreement, where an investor permits the stockbroker to operate his/her account as per the given instructions.

Investors are also issued a DP ID, or Depository Participant ID, by their preferred broking firm or other financial institutions. DP ID forms a part of one's account number, as this ID denotes the first eight-digit of the account number.

Both depository and depository participants use this data when an investor converts physical shares to Demat, transfers shares from one Demat account to another, or transfers money from a Demat account to a bank account.

5.15.7 : TYPES OF DEMAT ACCOUNTS :

Now that we've understood Demat Account definition let's look at the types of Demat Account. There are mainly three types:

i) Regular Demat Account - This is for Indian citizens who reside in the country.

ii) Repatriable Demat Account - This kind of Demat Account is for non-resident Indians (NRIs), which enables money to be transferred abroad. However, this type of Demat Account needs to be linked to a NRE bank account.

iii) Non-Repatriable Demat Account - This again is for the NRIs, but with this type of Demat Account, fund transfer abroad is not possible. Also, it has to be linked to an NRO bank account.

5.15.8 : CHARGES INCURRED ON ACCOUNT OF DEMAT ACCOUNTS :

Although any investor can open a free Demat account, there are certain charges that are levied on that account to ensure its smooth operations. Each brokerage firm (including banks) comes with its unique brokerage charges.

Some of those are as follows :

i) Annual Maintenance Charges :

Almost every firm levies a fee as an annual maintenance charge for Demat account. Depositories follow specific guidelines to calculate the fee applicable for each investor.

SEBI has implanted a revised rate for Basic Services Demat Account, or BSDA, from 1st June 2019. According to the revised guidelines, no annual maintenance charge will be applicable for debt securities of up to Rs.1 lakh, while a maximum of Rs.100 can be levied on holdings of Rs.1 lakh to Rs.2 lakh.

ii) Custodian Fees :

Depository partners charge a custodian fee as a one-time or annual basis. The sum is paid directly to the depository (NDSL or CDSL) by the company.

iii) Demat and Remat charges :

Such expenses are levied as a percentage of the total value of shares purchased or sold to cover all digitisation or physical print costs of securities.

Other than the above-mentioned fees, an investor is also liable to pay fees like credit charges, applicable taxes and CESS, rejected instruction charges, etc.

5.16 FUTURES AND OPTIONS

5.16.1 : INTRODUCTION

Derivative is a financial instrument, whose value depends on the values of basic underlying variable. In the sense, derivatives is a financial instrument that offers return based on the return of some other underlying asset, i.e. the return is derived from another instrument. For example, derivatives, that can be structured around any uncertainty. Stock prices are uncertain - Lot of forwards, options or futures contracts are based on movements in prices of individual stocks or groups of stocks; Prices of commodities are uncertain - There are forwards, futures and options on commodities; Interest rates are uncertain - There are interest rate swaps and futures; Foreign exchange rates are uncertain - There are exchange rate derivatives; and Weather is uncertain - There are weather derivatives, and so on.

Financial derivatives are financial instruments whose prices are derived from the prices of other financial instruments. Although financial derivatives have existed for a considerable period of time, they have become a major force in financial markets only since the early 1970s. In the class of equity derivatives, futures and options on stock indices have gained more popularity than on individual stocks, especially among institutional investors, who are major users of index-linked derivatives. Even small investors find these useful due to high correlation of the popular indices with various portfolios and ease of use. Derivative contracts have several variants. Depending upon the market in which they are traded, derivatives are classified as:

1) Exchange traded and

2) over the counter.

The most common variants are forwards, futures, options and swaps.

Here we are going to cover Futures and Options only.

5.16.2 : FUTURES

A] Introduction:

Futures refer to financial contracts thatobligate a seller to sell an asset or a buyer to buy an asset at apredetermined price and at a predetermined time in the future.

Today, most common assets which are traded in the futures marketare equities, commodities like metals (gold, silver, platinum),agriculture products (wheat, soya bean, cotton etc.), and stockindex and so on.

The future contract is an agreement between two partieswhere each party agrees to transact with respect to an underlyingasset at a predetermined price (future price) and at a specifiedfuture date. They are traded on future exchange; so, the exchangebecomes counter party. Future contract includes the settlementdate, description of asset on which futures are sold, size of contractand settlement cycle. Future contracts are marked to market and sothe settlement cycle is on daily basis.

A futures contract is an agreement between two parties tobuy or sell a particular asset on a specified future date. These are traded on recognised exchanges like NCDEX, MCX, NSE and BSEetc. The terms and conditions of a futures contract like contract size (quantity/ amount of the asset), price and price limits, delivery terms(delivery place and time) and position of a trader (long or short) arestandardized by the exchanges where they trade. Thus, futures arean exchange traded derivatives.

Trading of futures commenced from June 2000, and Internet trading was permitted in February 2000.

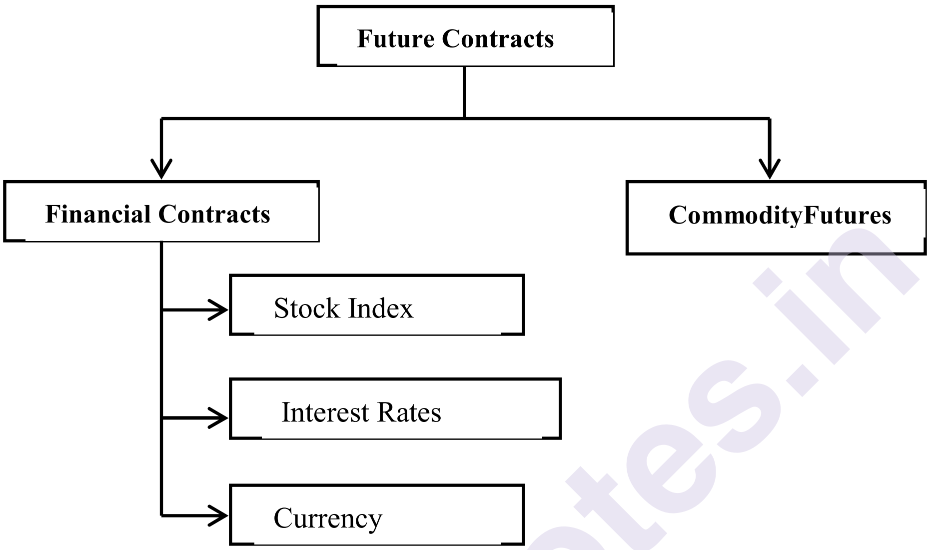
In a futures contract, the terms ofthe contract are determined by the exchange which initiates the contract. The price is determined by the parties to the contract. A futures contract is standardized as to quantity, quality and delivery terms.

B] Definition :

1. "Futures are exchange traded contracts to sell or buyfinancial instruments or physical commodities for futuredelivery at an agreed price" - Website of Bombay Stock Exchange.

2. "Futures contracts are organized/ standardized contracts,which are traded on the exchange -www.derivativesindia.com

C] Types of Futures Contract :



D] Examples :

On 1st January, Miss Pranali enters into a Future contractto buy 500 shares of 'SwabhavLtd.' at an agreed price of ₹ 150/- per sharein April. If on maturity date(as determined by the Stock Exchangeduring the month of December), the price of the Equity share rise to ₹ 170/-per share, Miss Pranali will receive ₹20 per share andotherwise if the price of share falls to ₹110/-, Miss Pranali will pay₹40/- per share.

Let's explain the concept with one more example:

Suppose, currently in summer, onions are being sold at ₹ 12 / Kg. Rekha is sure thatdue to bad weather in monsoon, the prices might go up during Diwali vacations, when she is willing to host her house warming function. So she will need a lot of onions for the function. Henceshe enters into a contract with a farmer in Lasalgaon, Nashik to buy 20kg onions during Diwali vacations at ₹12 per kg.

Now during Diwali vacations, the price of onions would either be ₹10 or ₹14 / Kg. In any case she paysfarmer ₹12 per kg (because farmer and she enteredinto a futures contract) and he delivers 20kg onions to her.

If during Diwali vacationsthe price of onions is ₹10 / Kg, she has saved ₹2 / Kg or overall ₹40.

If during Diwali vacationsthe price of onions is ₹14 / Kg, she has lost ₹2 / Kg or overall ₹40.

Let's elaborate with another realistic example :

- FUTIDX NIFTY 27 Feb 2020 is a futures contract on the Nifty index that expires on 27 Feb 2020.

- It is trading at ₹ 12000, which means buyers and sellers agree to buy/sell Nifty for a delivery value of ₹ 12000 on a future date (27 Feb 2020).

- It is available to trade from the date it is introduced by the exchange till its expiry date on 27 Feb 2020.

- On expiry, the settlement price at which this future contract will be settled may be higher or lower than 12000. If it is higher, the buyer who bought the future contract at a price of 12000 would make a profit and a seller who sold the futures contract at 12000 would make a loss. If the settlement price is lower, then the situation is reversed for the buyer and seller.

5.16.3 : OPTIONS

A] Introduction:

Options are derivative contracts, which splice up the rights and obligations in a futurescontract. The buyer of an option has the right to buy (in case of "call") or sell (in case of"put") an underling on a specific date, at a specific price, on a future date. The seller of anoption has the obligation to sell (in case of "call") or buy (in case of "put") an underlying ona specific date, at a specific price, on a future date. An option is a derivative contract thatenables buyers and sellers to pick up just that portion of the right or obligation, on a futuredate.

An option is a special type of contract which gives its holder the right (but not obligation) to buy or sell an asset at a fixed price at some future price at some future date. There are only two basics types of options, i.e., **Call option** and **Put Options**.

A call option is the right to buy an underlying asset at a specified price over a given time period, while a put option is a right to sell an underlying asset at a specified price over a given time period. According to the language of option contract, the owner who obtains (buys) the right to trade (buy/sell) an asset is known as option holder. The counterparty who grants (sells) the right as option writer.

A buyer of an option has the right to buy (in case of call) or sell (in case of put) theunderlying at the agreed price. He is however not under obligation to exercise the option.

The seller of a call option has to complete delivery as per the terms agreed. For granting thisright to the buyer, the seller collects a small upfront payment, called the option premium,when he sells the option.

A call option represents a right to buy a specific underlying on a later date, at a specific pricedecided today. A put option represents a right to sell a specific underlying on a later date, ata specific price decided today.

The Securities Contracts (Regulation) Act, 1956 was amended in 1995-96 for introduction of options trading.

Conceptually, the option contract is shown below:

i) Right to Buy Option :

Parties	**Buyer of the Asset**	**Seller of the Asset**
Status	Option Holder	Option Writer
Right	Yes	No
Obligation	No	Yes

ii) Right to Sell Option :

Parties	**Buyer of the Asset**	**Seller of the Asset**
Status	Option Writer	Option Holder
Right	No	Yes
Obligation	Yes	No

Thus, the option holder is the buyer of the option and theoption writer is the seller of the option.

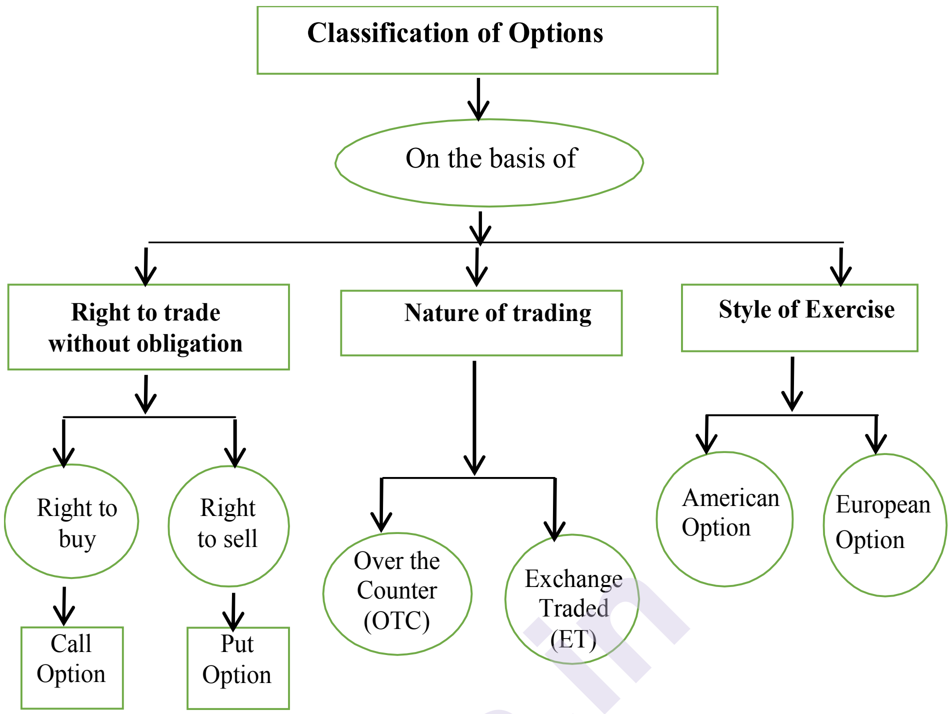
B] Definition :

1. Option is a financial derivative that represents a contractsold by one party (option writer) to another party (option holder).The contract offers the buyer the right, but not obligation to buy(call) or sell (put) a security or other financial asset at an agreedupon price (the strike price) during a certain period of time or on aspecified date.

2. “An option is a derivative contract or instrument that givesthe option holder the right, but not obligation, to trade an underlyingasset for a specific price on or before a specified time price.

C] Types / Classification of Options Contract :

Options may be classified on the basis of right to tradewithout obligation, styles of exercise and nature of trading.



i) Types of Option on the Basis of Right :

On the basis of "right to trade without obligation", optionsmay be classifies as call options and put options:

Conceptually, these two types of options are shown below:

Option type	Buyer of the right	Seller of the right
Call	Right to buy at the specified price	Obligation to sell at the specified price.
Put	Right to sell at the specified price	Obligation to buy at the specified price.

ii) Types of Option on the Basis of nature of Trading :

There are two types of option trading, i.e., Exchange tradedoptions and Over the Counter traded options.

The option can be traded on an organised or on the over thecounter (OTC) market. An exchange traded option contract is verysimilar with futures while an OTC option is like a Forward Contract.

iii) Types of Option on the Basis of Style of Exercise :

In finance, the style of an option denotes the date on whichthe option may be exercised. Depending on when an option can beexercised, it is classified in to the following two categories :

(a) American Style Option or American Option - In this style, theoption can be exercised by the option holder during any timeduring the life of the contract i.e., on or before the expiration date.

Thus, in an American style, the option holder has right to exercisehis right to buy/ sell any time before the expiry date.

(b) European style Option or European option - In this style, theoption may be exercised only on the expiry date of an option, i.e. ata single pre-defined point of time.

D] Examples :

Shekhar buys a call option on the Nifty index from Krunal, to buy the Nifty at a value of ₹11,900,one month from today. Shekhar pays a premium of ₹110 to Krunal.

What does this mean?

- Shekhar is the buyer of the call option.
- Krunal is the seller or writer of the call option.
- The contract is entered into today, but will be completed one month later on thesettlement date.
- ₹ 11,900 is the price Shekhar is willing to pay for Nifty, one month from today. This is calledthe strike price or exercise price.
- Shekhar may or may not exercise the option to buy Nifty at ₹ 11,900 on the settlementdate.
- But if he exercises the option, Krunal is under obligation to sell the Nifty at ₹ 11,900 toShekhar.
- Shekhar pays Krunal ₹110as the upfront payment. This is called the option premium. Thisis also called as the price of the option.
- On settlement date, Nifty is at ₹ 12,200. This means Shekhar's option is "in the money." He can buy the Nifty at ₹ 11,900 by exercising his option.
- Krunal earned ₹110as premium, but lost as he has to sell Nifty at ₹ 11,900 to meet hisobligation, while the market price is ₹ 12,200.
- On the other hand, if on the settlement date, the Nifty is at ₹ 11,800, Shekhar's option willbe "out of the money."
- There is no point paying ₹ 11,900 to buy the Nifty, when the market price is ₹ 12,200. Shekharwill not exercise the option. Krunal will retain the ₹ 109 he collected as premium.

After necessary approvals from SEBI, derivative contracts in Indian stock exchanges begantrading in June 2000, when index futures were introduced by the BSE and NSE. In 2001,index options, stock options and futures on individual stocks were introduced. India is oneof the few markets in the world where futures on individual stocks are traded. Equity indexfutures and options are among the largest traded products in derivative markets world over.

You will learn the 'Futures and Options' in detail in Modules no. 1 & 2 : 'Derivatives - Futures' and 'Derivatives – Options' resp. of the subject : International Finance in the same semester of your course.

5.17 CASE STUDY

A speculator believes that the stock price of a particular company will go up from ₹ 200 to ₹ 250 in the next three months and wants to act on this belief by taking a longposition in that stock. Alternatively, he can take a long position in that stock through futures market as well.

Suppose he buys a three months futures contract of that stock (1 lot of 100 shares), he neednot pay the full amount today itself and pays only the margin amount today. If the marginrequired for this stock is 10%, then he needs ₹ 200 x 100 x 10% = ₹ 2000 to take this longposition in futures contract.

If there isdifference in returns between the spot position and futures position, it is due to the leverageprovided by the futures contracts. This leverage makes the derivatives a preferred productof speculators. However, the same leverage makes the derivatives products highly risky. Ifthe market had moved against his prediction, the losses that investor would have incurredwould have been many times the loss on the spot market position.

Questions :

1) If he buys 100 shares of this company in spot market (delivery), how much amount he will need to enter into this position?
2) If his prediction comes true andthe stock price moves up ₹ 250, how much profit will he gain per share andtotal amount of profit orhow much loss per share andtotal amount of loss will he incur?
3) If he gains profit, how much would be the return on investment? Explain.

5.18 SUMMARY

Finance comprises of blend of knowledge of credit, securities, financial related legislations, financial instruments, financial markets and financial system.

Capital Budgeting is budgeting for capital projects. It analyses investment opportunities and cost of capital simultaneously while evaluating worthiness of a project.

Capital Budgeting is the most important decision for a finance manager. As it involves buying expensive assets for long term use, Capital Budgeting decisions may have a role to play in the future success of the company.

Capital Budgeting is the process of evaluating capital projects which has cash flows more than one year. It involves huge investment in capital assets hence it becomes necessary to make in depth analysis of the options available to the finance manager of the business. In Capital Budgeting decisions a project is accepted if it has positive net cash flows. Positive cash flow means Excess of present Value of Cash inflows over the Present investment value.

The process involves ascertaining or estimating cash inflows and outflows, matching the cash inflows with the outflows appropriately and evaluation of desirability of the project. It is a managerial technique of meeting capital expenditure with the overall objectives of the firm. Capital Budgeting means planning for capital assets.

Capital Budgeting provides useful tool with the help of which the management can reach judicious investment decision. Capital projects involve huge outlay and long years.

The overall objective of Capital Budgeting is to maximise the profitability of a firm or the return on investment. This objective can be achieved either by increasing the revenues or by reducing costs. Thus, Capital Budgeting decisions can be broadly classified into two categories: a) those which increase revenue, and b) those which reduce costs.

It is significant because it deals with the vital decision of evaluation and selection of efficient project. Many criteria has been suggested to judge the worth commendability of investment projects. Capital projects need to be thoroughly evaluated as to costs and benefits.

The Capital Budgeting process begins with collecting innumerable alternative investment proposals or projects from different departments of a firm which would meet the requirements of the business concern. The best alternative from among the conflicting proposals is selected using appropriate Capital Budgeting techniques. This selection is made after estimating return on the projects and comparing the same with the cost of capital. Investment proposal which gives the highest net marginal return will be chosen.

Following are the steps involved in the evaluation of an investment: 1) Estimation of cash flows, 2) Estimation of the required rate of return and 3) Application of a decision rule for making the choice. A sound appraisal technique should be used to measure the economic worth of an investment project.

Further, in view of the investment proposals under consideration, Capital Budgeting decisions may also be classified as. i) Accept / Reject

Decisions, ii) Mutually Exclusive Project Decisions and iii) Capital Rationing Decisions.

The various techniques of investment appraisal methods include : Non-discounted Cash Flow Criteria includes (i) Pay-back period, (ii) Discounted pay-back period and (iii) Accounting rate of return (ARR).

Discounted Cash Flow (DCF) Criteria includes (i) Net present value (NPV), (ii) Profitability index (PI) and (iii) Internal Rate of Return (IRR)

Investment decisions : These decisions involve the profitable utilization of firm's funds especially in long-term projects (capital projects). Since the future benefits associated with such projects are not known with certainty, investment decisions necessarily involve risk. The projects are therefore evaluated in relation to their expected return and risk.

The second critical function is financial decision-making. It is concerned with a company's capital – mix, financing – mix, or capital structure. The proportion of debt capital and equity capital is referred to as capital structure. A firm's financing decision is related to the financing – mix.

The dividend policy decision is the third major function. Decisions on dividend policy are concerned with the distribution of a company's profits to its shareholders, how much of the profits should be distributed as dividends, specifically, the dividend pay-out ratio, etc.

Capital structure refers to the composition of capital. Funds can be collected from various sources such as by issue of shares, debentures, fixed deposits, obtaining loans from banks and financial institutions and so on. It is necessary to have a right blend of various funds, which will ensure liquidity, flexibility, economy and stability. Financial management aims at bringing about a proper balance between the various sources of funds.

Capital Market is a market for long-term sources of finance to the industrial and corporate sector. Capital Market deals with long-term funds. These funds are subject to uncertainty and risk. It supplies long and medium term funds to the corporate sector. It provides the mechanism for facilitating capital fund transactions. It deals in ordinary shares, bond debentures and stocks and securities of the government.

In this market the funds flow will come from savers. It converts financial assets into productive physical assets. It provides incentives to savers in the form of interest or dividend to the investors. It leads to capital formation.

Capital Market plays a vital role in the development by mobilizing the savings to the needy corporate sector. In recent years there has been a substantial growth in the Capital Market.

The Capital Market involves in various functions and significance.

Capital Market is a market for long-term funds. It requires a well-structured market to enhance the financial capability of the country. The market consists of a number of players. They are categorized as:

1. Companies

2. Financial Intermediaries

3. Investors

The Indian financial system is both developed and integrated today. Integration has been through a participatory approach in granting loans as well as in saving schemes. The expansion in size and number of 59 institutions has led to a considerable degree of diversification and increase in the types of financial instruments in the financial sector which are wholly owned by the government. In a Capital Market, banks and financial institutions are the important components. They act as catalysts in the economic development of any country. The main components of the Capital Market in India are:

1. New-issue Market (Public issues) (Primary Market)

2. Secondary Market (Stock Market)

The Indian Capital Market is regulated by The Securities and Exchange Board of India (SEBI).

The Capital Markets consist of a number of individuals and institutions. The Government is also an important player in the Capital Market. The players in the Capital Market channelize the supply and demand for the long-term capital. The constituents of the Capital Markets are, the stock exchange, commercial banks, cooperative banks, saving banks, development banks, insurance companies, investment trusts and companies etc.

Fundamental analysis is the study of economic factors, industrial environment and the factors related to the company.

The state of the economy determines the growth of gross domestic product and investment opportunities.

An economy with favorable savings, investments, stable prices, balance of payments, and infrastructure facilities provides a best environment for common stock investment.

The leading, coincidental and lagging indicators help to forecast the economic growth. A rising stock market indicates a strong economy ahead.

Industrial growth follows a pattern. Buying of shares beyond the pioneering stage and selling of shares before the stagnation stage are ideal for the investors.

The cost structure, research and development and the government policies regarding the industries influence the growth and profitability of the industries. SWOT analysis reveals the real status of the industry.

The competitive edge of the company could be measured with the company's market share, growth and stability of its annual sales.

Technical Analysis analyses the behaviour of the security pricesthrough different charting techniques and different chart patterns.

According to the technical analyst's their method is simple andgives an investor a bird's eye on the future of security price bymeasuring the past moves of prices. They predicted the stockprices through Line Chart, Bar Chart, And Candlestick Charts andother. Technical analysis includes the study of various chartpatterns such as Support and Resistance, Head and Shoulders,Triangles and Flag Pattern which helps to predict the upward anddownward swing in the market. Following are few concepts used incharting techniques:

- Resistance — a price level that may prompt a net increase ofselling activity
- Support — a price level that may prompt a net increase ofbuying activity
- Trending — the phenomenon by which price movement tends topersist in one direction for an extended period of time
- Average true range — averaged daily trading range, adjusted forprice gaps
- Chart pattern — distinctive pattern created by the movement ofsecurity prices on a chart
- Momentum — the rate of price change
- Point and figure analysis — a priced-based analytical approachemploying numerical filters which may incorporate timereferences, though ignores time entirely in its construction.
- Cycles - time targets for potential change in price action (priceonly moves up, down, or sideways)

A Demat account is an Indian term for a Dematerialized account that holds financial securities (equity or debt) digitally and to trade shares in the share market. In India, Demat accounts are maintained by two depository organizations: the National Securities Depository Limited and the Central Depository Services Limited.

A depository participant (DP), such as a bank, acts as an intermediary between the investor and the depository. In India, a DP is described as an agent of the depository. The relationship between the DPs and the depository is governed by an agreement made between the two under the

Depositories Act. The Demat account number is quoted for all transactions to enable electronic settlements of trades to take place. Access to the dematerialized account requires an internet password and a transaction password which allows the transfers or purchases of securities.

Demat accounts play a crucial role in stock market investments, as it is one of the most common methods of investing in the stock market. However, recently, several online platforms provide the benefit of online trading without such accounts.

Futures : A futures is a contract for buying or selling a specific underlying, on a future date, at a price specified today, and entered into through a formal mechanism on an exchange. The terms of the contract (such as order size, contract date, delivery value and expiry date) are specified by the exchange.

Future Contracts are exchange traded contracts between two parties to trade (buy/ sell) standardized financial instruments or physical commodities. The terms of the contracts such as quality, quantity, delivery time and delivery place and settlement procedure are standardized by an Exchange.

A futures contract can be bought or sold on the exchange in the derivative segment of the market. Orders placed by buyers and sellers on the electronic trading screen are matched.

The price of the futures contract moves based on trades, just as it does in the cash or spot market for stocks.

Options : Options are derivative contracts, which splice up the rights and obligations in a futures contract. The buyer of an option has the right to buy (in case of "call") or sell (in case of "put") an underling on a specific date, at a specific price, on a future date.

An option is the right to buy or sell a particular asset for a limited time at a specified rate. These contracts give the buyer a right, but do not impose an obligation, to buy or sell the specified asset at a set price on or before a specified date.

An option is a special type of contract between two parties where one party grants the other party the right to buy or sell a specific asset or commodity (or instrument) at a specified price within a specific time period. There are only two basic type of option i.e., call option and put option.

Call option means right to buy without obligation while put option means right to sell without obligation. To get the right, the buyer has to pay premium to the seller of the option. The buyer of the option is known as option holder while the seller of the option is known as writer. There are two distinctive styles of option contract. i..e. European style and American style.

5.19 EXERCISE

Q. 1) Fill in the blanks with appropriate words :

1. Capital Market is a market for long-term finance to the ------------- and --------------- sectors. (Industrial, banking, retailing,corporate)
2. Capital Market supplies ----------------- and ------------ terms fundsto the corporates. (long, short, medium, very-long)
3. The role of money market is creation of ------------------- (liquidity,time deposits, term deposits, foreign exchange).
4. Long-term capital represents the amount of capital invested inthe form of ------------. (fixed assets, immovable assets,movable assets, money markets)
5. Short-term capital represents the amount of capital invested in ----------- assets. (fixed, current, movable, immovable)

Q. 2) State with reason whether the following statements are True or False :

1. Capital Budgetingissameasfinancingdecision
2. Capital Budgetingdecisionsarereversibleinnature.

Answers :

1. **False** :Capital Budgeting is same as investment decision.
2. **False** : Capital Budgeting decisions are irreversible in nature as huge investment is involved and reversing decisions would involve additional costs and losses

Q. 3) Answer the following :

1) What is Capital Budgeting?
2) Explain the significance of budgeting.
3) What are the various kinds of Capital Budgeting decisions?
4) What is meant by Capital Budgeting process?
5) Analyse the importance steps involved in Capital Budgeting.
6) Explain need for investment decisions.
7) Explain the process involved in Capital Budgeting.
8) Explain the functions of Capital Market.
9) Who are the players in Capital Market?
10) Explain the structure of Capital Market.

11) Comment on the constituents of Capital Market.

12) Elaborate the functions of Capital Market.

13) Elucidate the components of Fundamental analysis.

14) Explain the Technical analysis and its assumptions.

15) What are the charts? How are they interpreted in technicalanalysis?

16) Explain the different types of charting techniques.

17) Explain the different chart patterns.

18) Explain the meaning and working of Demat account.

19) Enumerate the stages of Venture Capital.

20) Explain the working of Demat account.

21) Which are the types of Futures?

22) Elucidate Futures with example.

23) Which are the types of Options?

24) Elucidate Options with example.