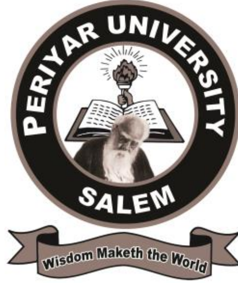

PERIYAR INSTITUTE OF DISTANCE EDUCATION (PRIDE)

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BACHELOR OF BUSINESS ADMINISTRATION (B.B.A)

SECOND YEAR

ALLIED – II : ECONOMICS AND GLOBAL BUSINESS

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BACHELOR OF BUSINESS ADMINISTRATION (B.B.A)
SECOND YEAR
ALLIED – II : ECONOMICS AND GLOBAL BUSINESS

UNIT I

UNIT II

UNIT III

UNIT IV

UNIT V

BACHELOR OF BUSINESS ADMINISTRATION (B.B.A)
SECOND YEAR
ALLIED – II : ECONOMICS AND GLOBAL BUSINESS

Unit - I

Meaning and Scope of Business Economics - Objectives of Profit Maximization - Social Responsibilities of Business.

Unit - II

Demand Analysis - Elasticity of demand - Demand Forecasting - Business cycle - Types of Business Cycles - Phases of Business Cycles

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ECONOMICS AND GLOBAL BUSINESS

Scheme of Lessons

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1. Meaning and Scope of Business Economics
2. Objectives of Profit Maximization
3. Social Responsibilities of Business

Unit - II

4. Demand Analysis
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LESSON - 1

MEANING AND SCOPE OF BUSINESS ECONOMICS

Business Economics is comparatively a new discipline. It is a special branch of Economics applied in business decision making. Business Economics means the application of economic theory to the problem of management. It is primarily concerned with the applicability of economic concepts and analysis to decision making in business.

The perspective of business economics is quite different from that of conventional microeconomics, in studying decisions.

The emphasis of business economics is on managerial economics, rather than on predicting the equilibrium position of an industry.

Business Economics thus lies on the border line of management and economics and serves as a bridge between the two disciplines. Moreover, a basic understanding of definitions and scope Economics is most essential for a greater understanding of business economics.

Definitions of Economics

The science of Economics was born with the publication, in 1776, of Adam Smith's magnum opus, "An enquiry into the Nature and Causes of Wealth of Nations." At its birth, it was baptized as Political Economy - and appellation which remained in use for nearly a century after its birth. No doubt, sporadic attempts were made in the early part of the 19th century to bestow new names upon it. Whately suggested Catallactics or the science of exchanges; Hearn called it Plutology or the science of wealth; and Ingram insisted on naming it as Chrematistics or the science of money - making. Despite these attempts, the original appellation of Political Economy continued to survive the early and the middle part of the 19th century. Towards the close of the century, however, there was a definite change from Political Economy to Economics. In this connection, it is worth remembering that the word 'Economics' was derived from the Greek words Oikos (a house) and nemein (to manage) which, in effect, meant managing a household, using the limited funds available in the most economical manner possible. Thus, the term 'Economics' was applied to a frugal use of one's limited resources and the term 'Economy' to the manner in which a particular society organized its resources for the maximum production of desired goods and services.

At present, there is a plethora of definitions of Economics available in the field. Broadly speaking, the various definitions of Economics can be lumped together under four heads; (i) 'Wealth' (ii) 'Welfare' (iii) 'Scarcity', and (iv) "Growth'.

Wealth Definition

Adam Smith is commonly known as the Father of Economics. He is associated with the Classical School of Economics. Adam Smith defines 'Economics as the Science of Wealth'. He laid emphasis on material wealth, the wealth being the object of man's desires.

According to Adam Smith, the main purpose of all economics activities is to acquire as much wealth as possible. Thus he emphasized the production and expansion of wealth as the subject - matter of economics. Wealth is, therefore, regarded as the be-all end-all of all economic activities.

Other Classical economists like J.B. Say, David Ricardo, Nassau Senior, J.S. Mill, F.A. Walker and J.E. Cairnes too regarded economics as the study of wealth.

Though wealth definition was a pioneering attempt made by Adam Smith to define economics, it is not free from criticism. Since Adam Smith laid exclusive stress on material wealth, it was severely criticized by men of letters like Ruskin and Carlyle as 'Gospel of Mammon' 'a pig science', 'a dark and dismal science', and also was dubbed as the 'bread and butter science'. Ruskin went to the extent of criticizing Economics as 'a bastard science, the science of getting of getting rich'.

Besides, by restricting the definitions of wealth to material wealth and the neglect of immaterial service in his study Adam Smith narrowed down the scope of economics.

Thus, wealth definition was considered unsatisfactory, unscientific and incomplete and as such discarded towards the close of the 19th Century.

Welfare Definition

Alfred Marshall, a prominent English economist is associated with the Neo-Classical School of Economics. He published his celebrated book "Principles of Economics" in the year 1980. In this book, Marshall defines 'Economics as the Science of Material Welfare'. The credit goes to Alfred Marshall for shifting the emphasis from wealth to man and also from wealth to welfare. He laid emphasis on man and his welfare. By shifting from 'Wealth' to 'Welfare', Marshall has not only enlarged the realm of economics, but also elevated it to the status of social science.

Marshall pointed out that Wealth is not an end in itself, but only a means to an end, the end being the promotion of human welfare. He gives primary importance to 'Man and his Welfare' and only secondary importance to Wealth.

According to him, economics is a practical science since it deals with man's actions in the ordinary business of life, and studies how man gets his

income, how he uses is and how he makes the best use of his resources. Thus it is, on the one side, a study of wealth; and on he other and more important side, a part of the study of man. To him, economics examines that part of individual and social action which is most closely connected with the attainment and the use of material requisites of well - being.

Other neo-classical economists like A.C.Pigou, E.Canan and W.Beveridge too regarded Economics as the study of material welfare.

Though welfare definition of Marshall, no doubt, is a great improvement over the wealth definition, it too is not free from criticism. Robbins criticizes the welfare definition on the ground that it is 'classificatory' rather than 'analytical' in character. That is, it included only material welfare of human beings but excluded non-material welfare. As such, the welfare definition is highly unsatisfactory.

Scarcity Definition

Prof. Lionel Robbins is associated with the London School of Economics. He provides a new and scientific definition of economics. He published his famous book "An Essay on the Nature and Significance of Economics Science" in the year 1932. In this book, Robbins defines Economics as "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses".

This definition highlights three fundamental features of human existence. They are:

(1) Unlimited ends

(2) Scarce means

(3) Alternative uses of Scarce means

It is evident that an economic problem arises only when the above conditions are fulfilled simultaneously.

Robbins 'definition raises a fundamental issue, namely, scarcity of means in relation to unlimited ends and the consequent problem of choice. Whenever the resources are scarce and the wants are many, the question of choice arises. The man has to choose between the wants to which resources are to be allocated.

Economists like Eric Roll, A.P. Lerner, George J. Stigler, Cairncross have defined economics on Robbins lines.

Like the 'Welfare definition, the 'Scarcity' definition too is not free from critism. Critics pointed out that an economic problem does not always arise from scarcity as suggested by Robbins. It can arise from abundance as well. For example, the Great Depression of the 'Thirties, Robbins' has also been criticized

on the ground that he has made economics neutral between ends. Critics are also of the view that if economics is to serve as an engine of social betterment, it would have to abandon the neutrality between ends.

Growth Definition

Prof. Paul A. Samuelson has given a growth - oriented definition of economics. His definition runs as follows:

"Economics is the study of how men and society end up choosing, with or without the use of money, to employ scarce productive resources that could have alternative used to produce various commodities, now or in the future, among various people and groups in society. It analyses the costs and benefits of improving patterns of resource allocation".

Samuelson has pointed out three fundamental aspects in his definition. They are:

(1) Human behavior

(2) Allocation of scarce resources

(3) Alternative uses of resources

Economics is not a bundle of theories and principles, it is a practical social science. The study of the subject is not undertaken, merely for the sake of knowledge. It is done to lay down principles and policies for removing poverty and increasing human welfare.

Scope of Economics

The scope of economics means the limits of its subject matter. From the definition we can understand the scope of economics. It studies man in the ordinary business of life and how he earns his income and how he satisfies his wants. It is concerned not with individual actions but with social actions. It studies how wealth is produced with limited resources in order to satisfy human wants. It studies about problems arising out of multiplicity of wants and scarcity of resources which satisfy these wants. It studies how wealth is produced, consumes, exchanged and distributed.

Satisfaction of human want is called consumption which forms one of the important branches of economics. This tells how people behave in consumption of goods and services in order to maximize their satisfaction. Goods and services have to be produced with the help of factors of production. So, Production is another important branch of economics. This tells how maximum goods are produced with minimum cost or how the scarce factors could be utilized economically for better results. Goods and services cannot be produced at one place or at one point of time. Goods produced by one are exchanged for the goods produced b the other. So, Exchange forms another important branch

of economics. Goods and services are produced with efforts, i.e., by combining the factors of production. These efforts have to be paid for or rewarded. The land gets rent, the labour gets wages, the capital gets interest and the organizer gets profit. This branch of study is called Distribution.

Besides these four branches, there is another important branch called public Finance. This studies about the sources of revenue to the government and the principle governing expenditure for the benefit of the people. It studies about public debt and financial administration.

Meaning of Business Economics

Business economics or what is also known as managerial economics is concerned with the application of economic theory and methods to the analysis of decision - making problem faced by business firms. The first and most important problem faced by a business firm is the selection of a product to be produced or service to be provided. The second important problem dealt with in business economics is to decide about price and output of the product so as to maximize profits or to attain some other desired goal. The decision regarding price and output requires careful analysis of the demand for a product and costs of its production. The other important decision-making problem that business firms face relate to what methods or techniques of production are to be used in the production of commodities, and how much advertisement expenditure is to be incurred for promoting the sales of a product.

It is important to note that business economics has both descriptive and prescriptive roles. Business economics not only explains how various economic forces affect the working of a firm but also predict the consequences of the decisions made by it. This is its positive or descriptive role. In addition to this business economics prescribes the rules for the improvement of decision making by firms or their managers so that they can achieve their objectives efficiently.

It should be noted that business economics also draws heavily on the decisions sciences for the techniques used for decision making. The techniques of decision sciences used especially for business decision making are optimization techniques, particularly differential calculus and mathematical programming. These optimization techniques are used in the analysis of alternative courses of action and the evaluation of results obtained so that best alternative which helps in attaining the objective is chosen. Besides optimization techniques, methods of statistical estimation, game theory of decision sciences are extensively used in business economics for developing decision rules that can help managers in achieving firm's objectives. It may however be noted that these techniques of decision sciences have now become

a part of modern economic theory. Therefore, business economics can be described as the use of theories and techniques of modern economics for decision - making problems of business firms.

It may be noted that business economics deals with not only private firms but also public enterprises. This is because mangers of all types of organizations face similar problems. In the last about three decades business economics has grown rapidly because it has been increasingly realized that economic theory and its methods and concepts can be used by mangers to achieve efficiently the desired objectives of the firm. Economics is primarily concerned with allocation of scarce resources to alternative uses so as to achieve maximum possible satisfaction of the people. Thus, Lord Robins defines economics as a "Sciences which studies human behavior as a relationship between ends and scarce means which have alternative uses". The type of decision - making by managers of business firms also usually involves question of resource allocation within a firm or organization. The resources at the disposal of a firm are scarce of limited. What product to be produced, what price should be fixed, how much quantity of it should be produced, and what factor combination or production technique be used for the production of goods involve resource allocation by a firm It is the task of manger of a firm that it should take decisions regarding these resource allocation problems in a way that ensure most efficient use of resources. Only this will enable the firm to achieve the goal of profit maximization.

Business Economics and Economic Theory

Economic theory has been broadly divided into microeconomics and macroeconomics. It is important to note that business economics draws on both microeconomics and macroeconomics. Microeconomics explains how an individual consumer chooses among goods so as to maximize their satisfaction and individual business firms decide to fix price and output of their products and what factor combination they use for producing them. The parts of microeconomics which deal with demand, theory, analysis of cost and production, theory of determination of price and output under different market structures are particularly useful in making decisions on such matters.

The study of macroeconomics which focuses on the economy as a whole is also highly useful for business economist who is faced with various decisions - making problems. This is because firms do not work in a vacuum. The levels of overall economic activity, national income and employment, aggregate demand condition, government policies (both fiscal and monetary), the general price level greatly affect business firms. These aggregates of the economy make up the overall economic environment which affects business decisions of

managers. Therefore, in recent years macroeconomics for management which is particularly relevant for business decision - making has been developed. Forecasts of future damned, investment decisions by business firms are especially based on the situation of overall economy and its growth prospects. Macro theories of consumption, investment demand, the general price level and business cycles are particularly relevant for making capital investment expenditure which yields returns in future years.

Decision making in Business

An enlightened business management will take scientific decisions after through study of Pros and Cons of a particular decision. The quality of the decision made by the management determines the successes or failure of the business venture. Decision making is the process of selecting particular course of action from among various alternatives. Every business manager has to work on uncertainties and the future cannot be precisely predicted by anyone.

Each type of decision of primary concern to business economics has many manifestations.

1. Selection of Products

The product decision may range from the launching of a major innovation following a long period of research. It may be a decision that is rare made such as the changing of the formula of an established soft drink. It may be made by a new firm or any established firm through a merger, or by building a new plant.

2. The choice of Production Methods

When highly generalized, the choice is the selection of the cost - minimizing combination of labour and capital, necessary to produce a particular output and is dependent on the state of technology and the relative prices of the factors.

3. Promotional Strategy

As long as the assumption of given tastes and preferences of consumers made, economic analysis has no place for a consideration of promotional expenditure.

With the relaxation of this assumption, promotion, defined as expenditure by the firms to shift demand curves, may become important Advertising expenditures involving such media as television, radio, magazines, newspapers and signboards, have run in the range of three percent to four percent of total consumption expenditures.

4. The Determination of Prices and Quantities

Price and quantity can be viewed as two aspects of the same decision. For firms with sufficient market power to have some discretion over price, the

quantity that can be sold will be determined by the price charged. When firms have to formulate price policies, a close relationship is likely to exist with product and promotional decisions

5. The Place or Location Decisions

The importance of the decision and the applicability of economic analysis with the spatial dimension added as it has been in location transpiration, regional and international economics, justify treating the place decision as the fifth type of decision with which business economics is primarily concerned. All these decisions are closely inter-related.

Chief Characteristics of Business Economics

It would be use full to point out certain chief characteristics of business economics, in as much as they throw further light on the nature of the subject matter and help in a better understanding thereof.

Firstly business economics is micro economics in character. This is because the unit of study is a firm. It is the problems of the business firm, which are studied in it, Business economics does not deal with the entire economy as a unit of study.

Secondly, business economy largely uses the body of economic concepts and principles which is known as "Theory of the firm" or "Economics of the firm"

In addition, it also seeks to apply profit theory, which forms part of the distribution theories in economics. Thirdly, business economics is pragmatic. It avoids difficult abstract issues of economics theory but involves complication in economic theory to face the overall situation in which decisions are made. Fourthly, business economics belongs to normative economics rather than positive economics and also sometimes known as descriptive economics. Fifthly, macro economics is also useful to business economics since it provides and intelligent understanding of the environment in which business must operate.

Scope of Business Economics

The scope of business economics is so wide that it covers almost the problems and areas of the manager and the business firm. Business economics deals with demand analysis, forecasting, production function, cost analysis, inventory management, advertising, price system, resource allocations, capital budgeting, etc,

Demand Analysis and Forecasting

When demand is estimated, the manager does not stop at the stage of assessing the current demand but estimates future demand as well. This is known as demand forecasting.

Productions Functions

It is a well known fact that means are limited and also capable of alternative uses. Inputs play a crucial role in the economics of production.

Factors of production are otherwise known as inputs. So, factors of production may be combined in such a way that there should be ideal combination of factors which yield maximum returns.

When prices of factors go up, a firm is forced to work out a combination of factors in such way to get the least cost combination of factors, which will result in maximum output at the least cost.

Inventor Management

An inventory refers to a stock of raw materials, which a firm keeps. Now, the problem is how much of the inventory is the ideal stock.

If it is high, capital is unproductively tied up, which might be used for other production purposes. On the other hand, if the level of the inventory is low, production will be affected.

Cost Analysis

Cost analysis is yet another function of managerial economics. Managerial economics touches these aspects of cost analysis, such as the determination of cost, the methods of estimating cost, the relationship between cost and output, etc., and an effecting knowledge and application of which is the corner stone for the success of a firm.

Advertising

To produce a commodity is one thing; to market it is another. Yet, the message about the product should reach the consumer before he thinks of buying it. Therefore, advertising firm is an integral part of decision making and forward planning.

Resource Allocations

Resources are not only limited but also capable of alternative used the aim to achieve optimization, for the purpose, some advanced trends, such as liner programming, etc., are used to arrive at the best course of action for a particular period.

Generally speaking, the main concern of the manager is to combine productive resources in such a way to get the least - cost combination of factors or optimum combination of factors.

Price System

The central functions of an enterprise are not only production but pricing as well. While the cost of production has to be taken into account when pricing a commodity, a complete knowledge of the price system is quite essential to the determination of the price.

Pricing is actually guided by considerations of cost plus pricing and the policies of public enterprises. Finally there is such a thing as price - leadership and non - price competition.

Therefore it is clear that the price system touches upon several aspects of managerial economics and aids or guides the manager to take valid and profitable decisions.

Capital Budgeting

If the manager wishes to arrive at meaningful decision, he must have a through understanding of the capital budgeting.

Capital is scarce and it has a price So he has to utilize scarce capital in the best manner possible, so as to get the best out of it. The manger must be capital or arriving at investment decisions under conditions of uncertainty and also to effect a cost - benefit analysis.

From the above analysis we understand that Business economics is applied economics, Business economics therefore plays a very vital role in the successful business operations of a firm.

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LESSON - 2

OBJECTIVES OF PROFIT MAXIMIZATION

Profit Maximization

Generally, profits are the primary measure of the success of any business. It is the acid test of the economic strength of the firm. Economic theory makes fundamental assumption that maximizing profit is the basic objective of every firm. This assumption does not always hold true, as in practice, the firms may not always try to maximize profits. This may be due to a number of reasons:

(1) **Achieving leadership:** Firms often like to become leaders in the respective line of business. They would rather try to attain industrial leadership at the cost of profits. In those cases, the objective of profit - maximization is subordinated to the leadership - goal in the field. Leadership may connote either maximum sales or manufacture of maximum product lines.

(2) **For avoiding potential competition:** Firms may restrict the profit in order to discourage other firms from entering the field and competing with them. If the firm is maximizing profit, it will be an alluring proposition for the new firms to enter the field of production. The new entrants may snatch away the market, make infringement on patent rights on the existing firm and may also encroach on the firm's resources of raw materials. In order to avoid such potential competition, the firms may adopt a policy of profit restriction, instead of profit - maximization. This is more so in the case of firms enjoying weak or slender monopoly.

(3) **For preventing Governments' intervention:** Higher profits in business is considered as an index of monopoly power. The government's attitude towards profit and the firm's attitude towards profit will be different. Maximum profit may create an impression that the firm is exploiting the consumers and this may result in the public in the public demand for nationalizing the firm or firms. The government may also probe into the financial structure of the firm, make regulation of prices, profits and dividends. Just to woo the public and to restrain the zeal of nationalization, the firms may adopt a policy of restricted profit.

(4) **For maintaining customers goodwill:** In modern business, customers goodwill is valued more than anything else. In order to maintain that, the firms may adopt the policy of restricted profit and low price for the commodity. Even in times of increased taxes and excise duties, these firms may not increase the price, but reduce the profit margin and thereby win the approbation of the customers.

(5) For restraining wage demands: Higher profit is an indication of ability to pay higher wages by the firms. Organized Trade Unions advance their arguments on the basis of higher profits earned by the firm for increasing the wages of laborers, bonus benefit, etc. But in India this point has no validity as wages of laborers are fixed by wage Boards and payment of minimum bonus is a statutory obligation. Hence, the firms may have no elbow - room for making decisions in this matter.

(6) For achieving financial soundness and liquidity: Some firms may give greater importance to financial soundness and liquidity, rather than profit - maximization. Considerations of maximum profit may result in huge investment in fixed assets and consequently the liquidity of the firm will be reduced.

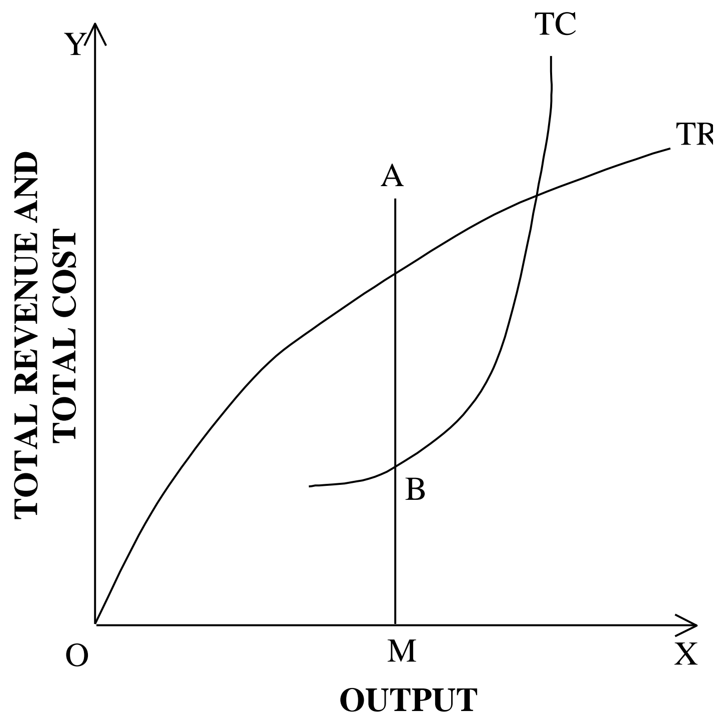
(7) For avoiding risks: Decisions regarding profit maximization may involve risks. Many new projects have to be worked through uncertainties. Generally, Business Managers will avoid taking those risks which may result even in losing their jobs or losing the image of the firm. Further, the rewards for Business Managers may not be directly proportional to the profits earned

From the foregoing analysis, we can see that all the factors enumerated, attempt to ensure profit - maximization in the long - run. But we cannot decisively say that the behavior of firms is always aimed at maximizing profit in the long - run.

The first duty of the business is to survive by avoiding losses. The guiding principle of business economics is not profit - maximization, but avoiding loss.

Business firms aiming at maximizing profits try to determine its output in such a manner as to obtain maximum net revenue. This is calculated either as a difference between total revenue and Total Cost or the difference between the Marginal Revenue and Marginal Cost.

We can find out the Total Revenue and total Cost of the firm for different levels of output. Where the difference between TR and TC is maximum, that level of output gives the maximum profit as shown in fig.



In the Fig. TR is Total Revenue and TC is Total Cost. AB is the maximum vertical distance between TR and TC and it shows maximum profit. CM is the Output which makes maximum profit.

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LESSON - 3

SOCIAL RESPONSIBILITY OF BUSINESS

Now, an important question is whether successful business firms always behave in a socially responsible way, that is, promotes social well - being, without harming it in any way, the answer is 'no'. Some argues that businesses exist by public consent to serve the needs of society. Therefore, they survive only because they promote social welfare. However this is not correct. Various problems are faced by society because of socially undesirable ways business firms perform their activities. Further, they impose certain social costs on the society for which they do not pay. However, society has taken steps to regulate and control them so as to induce or force them to serve social interest and minimize the harms done by them. We mention below the socially undesirable problems which the working of profit - driven business firm has created and how society has tried to regulate their activities to ensure that they work in public interest.

First problem that has been often faced is the emergence of monopolies in free market economies for the production of some important products or services. For example, economies of large - scale production and distribution are such that only one electricity producing and distributing company, only one company providing telephone service can efficiently serve a city. Such monopolistic firms are likely to exploit the consumers by charging higher prices and making excessive profits. It is in such cases that government on behalf of the society has intervened to directly regulate them. The Government has fixed fair prices for such commodities or services which are based on cost plus fair return on investment made by business firms.

The second problem posed by free private business is the emergence of oligopoly (that is, a few producers of a product competing with each other). In certain industries economics of scale are so large or barriers to entry into the industry are so string that only a few firms serve a given market. If there exists competition among these few firms no problem arises. But they formally or tacitly collude with each other and form a cartel, they pose a threat to social interest. Such collusion among the few firms eliminates or substantially reduces competition. Such collusion among the firms or formation of a cartel leads to higher monopoly price being charged and restriction of output. Such collusion or formation of a cartel has been sought to be controlled by the society through enacting laws such as antitrust law in the US and Monopolistic and Restrictive Trade Practices Act in India. These acts are designed to prevent collusion and creation of monopolies through merger. By promoting competition these laws

work for social betterment of the people and ensure social responsibility of business.

A further socially undesirable activity of free private business has been the exploitation of workers due to unequal bargaining power of the employers and workers. In India in private business enterprises, especially owned and managed by small-scale business, workers, workers are paid very low wages because they are not well - organized and also because huge unemployment prevails in the Indian economy. Employers even do not make arrangements for their housing which have resulted in slums in the cities. Further, child labour and women are employed in private enterprises ate very low wages while a lot of work is obtained from them. This has necessitated the regulation of business by Government which have fixed minimum wages that must be paid to workers. The employment of child labour has been banned. Law regarding 'equal pay for equal work' are being enforced under which women are to be paid equal wages as men.

But a very serious problem that arise in business activity is that it imposes a heavy social costs on the economy. It is now common knowledge that productive activities of business firms have created an acute problem of environmental pollution. The pollution creates lung ailments, asthma and other health hazards for the people. These are called social costs by the economists because while they impose these costs on the society they do not pay for them.

Now, a considerable attention is being paid by the society to internalize these social costs, that is, private businesses are forced to pay for these social costs. Safety standards are being laid down for emission limits on manufacturing processes and products that pollute. Provision for heavy fines have been made who do not provide adequate safeguards. Firms that do not meet these safety standards are even closed down.

It may be noted that all the above measures, namely regulation of monopolies, antitrust laws, labour laws and anti - pollution policies are examples of actions that society has taken to modify the profit maximizing behaviors of business firms os that they perform their task of producing and distributing goods and services in a socially responsible way. These social constraints have an important bearing on the business activities of firms and hence on managerial decision making.

Arguments for Assumption of Social Responsibilities

Normally, these arguments are put forward in favour of social responsibilities of business units.

1. Society expects the business community to assume social responsibilities of business units.

2. It is in the long term self - interest of business concerns, to assume social responsibilities.
3. When business starts assuming social responsibilities, it may reduce the pressure for and incidence of state regulations

Besides these arguments, it is also argued that businessmen are citizens as well as business promoters. So they are expected to use their corporate powers in such a way to develop a better world.

Prof. Paul Samuelson, a Nobel Prize winner in economics supports the assumption of social responsibilities by business units on the ground that prevention is better than cure. For example, it is often less costly and less unpleasant to avoid pollution than to clean in up.

Arguments against Assumption of Social Responsibilities

There are people who strongly, argue that businessmen have no social responsibilities except their classical function. Milton Friedman is of the opinion that the one and only social responsibility of businessmen is to use their resources and engage in activities which are designed to increase their profits, so long as their business stays within the rule of the game.

Further, according to Milton Friedman, those who urge business to assume social responsibilities are "preaching pure and unadulterated socialism".

Pragmatic View of Social Responsibilities

No doubt, there are powerful arguments in favor of profit maximization and complete exclusion of any social responsibilities of business. But even in a capitalist economy, profit maximization is "not generally as the sole aim of business". As business unit receives its profit from the society it has some responsibilities to spend part of its income to benefit the society.

Today we will be in more trouble with the authorities like the stock exchange and state regulations, etc., if we tried to run a business along old - fashioned grand fathers dairies for immediate profits rather that taking account of the public interest.

In a planned economy like India, the objectives of business has to be proper utilization of resources for the benefit of the society.

Profit is still a necessary part of the business goal but it is not a purpose of running a business.

The implies that utilization of the corporate resources should be manages not from the angel, "What is best for the shareholder", but from the point of view of "What is best for the community at large".

Responding to the demands of the public, many companies have agreed to pursuer major social programms on a voluntary basis.

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LESSON - 4

DEMAND ANALYSIS

Meaning of Demand

It is necessary to distinguish between demand and desire or need. A sickly child needs a tonic; a peon desires to have a TV set. But such needs and desires do not constitute demand. When, however, the person desiring is willing and able to pay for what he desires, the desire is changed into demand.

Demand is always at a price. "The demand for anything at a given price is the amount of it which will be bought per unit of time at that price". It simply means how much a person will be willing to buy of a commodity at a certain price I set of possible prices during some specified period of time. At another price he will, of course, buy a different quantity, more at a lower price and less at a higher price. To speak of demand without reference to price is meaningless.

Also, the demand is always per unit of time - per day, per week, per month or per year.

Here is a very good definition:

"By demand we mean the various quantities of a given commodity or service which consumers would buy in one market in a given period of time at various prices, or at various incomes, or at various prices of related goods."(Bober).

From the point of view the seller, the demand price is the average avenue (revenue per unit) or income he expects to earn from the sale of a unit of a commodity. Thus, demand price is identical with average revenue (AR). That is why, the demand curve is also drawn as AR curve.

Types of Demand

Three kinds of demands may be distinguished:

(a) Price Demand;

(b) Income Demand; and

(c) Cross Demand.

Price Demand. Price demand refers to the various quantities of a commodity or service that a consumer would purchase at a given time in a market at various hypothetical prices. It is assumed that other things, such as consumer's income, his tastes and prices of inter - related goods, remain unchanged.

The demand of the individual consumer is called **Individual Demand** and the total demand of all the consumers combined for the commodity or

service is called Industry Demand. The total demand for the product of an individual firm at various price is known as firm's demand or **Individual Seller's Demand.**

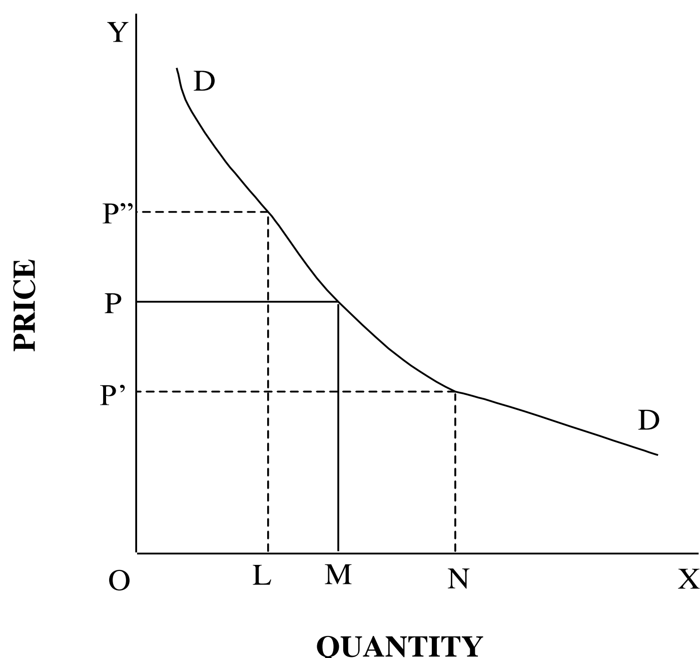
Income Demand. The income demand refers to the various quantities of goods and services which would be purchased by the consumer at various levels of incomes. For preparing demand schedule of income demand, we write income in one column and quantities purchased at these incomes in the second column. Superior goods or high - prices articles command brisk sales when income increases. On the other hand, inferior goods command large sales when incomes are at a lower level.

Cross Demand. The cross demand means the quantities of a good or service which will be purchased with reference to change in price not of this good but of other inter-related goods. These goods are either substitutes or complementary goods. A change in the price of tea, for instance, will affect the demand for coffee. Similarly, if horses become cheap, demand for carriages may increase. In order to prepare demand schedule of this type, we write prices of one commodity in one column and the quantities purchased of the other commodity in the second column.

Of these types of demand, price demand is the most commonly spoken one. Now we study demand schedule, demand curve, etc., relating to price demand.

DEMAND CURVE

We give here a demand curve of an imaginary consumer.



The demand curve simply shows how the quantity purchased varies with the variation in price. Along OX are represented the quantities of the good purchased and along OY the prices. It will be seen that at the price OP, OM quantity is purchased, at O the quantity purchased in ON and at O price OL. As the price falls, more is purchased, and vice versa. The demand curve is also known as the Average Revenue (AR) curve, because the price paid by the consumer is revenue per unit (i.e., average revenue) for the seller.

Why Demand Curve Slopes Downwards

Generally, the demand curve slops downwards. This is in accordance with the law of diminishing marginal utility. The purchases of most of us are governed by this law. When the price falls, new purchasers enter the market and old purchasers will probably purchase more. Since this particular commodity has become cheaper, it will be purchased by some people in preference to other commodities.

There are three obvious reasons why people buy more when the price falls:

(i) A unit of money goes farther and a consumer can afford to buy more. He is able and willing to buy more because the thing being cheaper, his real income increases. It is called income effect.

(ii) When the commodity becomes cheaper, it tends to be substituted wholly or partly for other commodities. This is called substitution effect.

The income effect and substitution effect combine to increase the ability and willingness of the consumer to buy more of the commodity whose price has fallen.

(iii) A commodity tends to be put to more uses or less urgent uses when it becomes cheaper. For example, if water is dear, we shall use it for drinking only; but when it become cheaper, we shall use it for washing and other less urgent uses.

Thus, the old buyers more and some new buyers enter the market. The cumulative effect is an extension of demand when price falls.

The law of diminishing marginal utility too is the basis of the law of demand. The consumer will buy more only if the price falls because more he buys the lower is the marginal utility.

Exceptional Demand Curves

Generally the demand curve slopes downwards to the left. But sometimes the demand curve, instead of sloping downward, will rise upwards. In order words, sometimes people will buy more when the price rises. This can be represented only by a rising demand curve. Such cases are very rare, but we can

imagine some. These were first investigated by Sir Robert Giffen. The Giffen Paradox holds that the demand is strengthened with a rise or weakened with a fall in price.

Benham has mentioned four such cases:

(1) When a serious shortage is feared, people get panicky and buy more even though the price is rising. This is expectational rise in prices.

(2) In case the use of a commodity confers distinction, the wealthy people will buy more when distinguished personages. Conversely, people tend to cut their purchases, if they believe the commodity to be inferior.

(3) Sometime people buy more at a higher price in sheer ignorance.

(4) If the price of necessity of life goes up, the consumer has to readjust his whole expenditure. He may cut down his expenses on other food articles and in order to make up, more may have to be spent on his particular good. Thus, more of this commodity will be purchased in spite of its high price.

In terms of income elasticity, the demand curves slope downward in the case of goods with positive income elasticities and upward when there is strong negative income elasticity.

Law of Demand

We are now in a position to formulate the law of Demand. This law simply expresses the relation between quantity of a commodity demanded and its price. The law states that demand varies inversely with price, not necessarily proportionately. If the price falls, demand will extend, and vice versa. The law of demand indicates this inverse relationship between price and quantity demanded.

The law can also be stated thus: "A rise in the price of a commodity or service is followed by a reduction in demand, if conditions of demand remain constant."

The qualifying phrase "the conditions of demand remaining constant" is very important. Demand is subject to several influences, which will be discussed presently, and the operation of any of those influences may counteract the law.

In Marshall's words, "The greater the amount to be sold, the smaller must be the price at which it is offered in order that it may find purchasers; or in other words, the amount demanded increases with a fall in price and diminishes with a rise in price."Obviously, the law of demand is based on the law of diminishing marginal utility. In other words, it is the law of diminishing marginal utility which explains the law of demand.

Demand thus is a function of price, i.e., it varies with price and can be expressed as D = F (P). Here D is demand and P is price.

It may also be added that no proportionality in the change is implied. If the price falls by 10 percent, it does not follow that the demand will increase exactly by 10 percent. We can only say that the demand will extend when the price falls, but we cannot say how much, this will depend on the elasticity of demand which we shall discuss shortly.

Limitations of the Law. There are, however, certain exceptions to the law of demand. That is there are cases in which demand does not contract when price rises, and vice versa. These cases are indicated by exceptional (upward rising) demand curves discussed above. The law will hold if the conditions of demand remain the same. These conditions relate to the consumer's tastes, his income, price of other goods, possibility of substitutes, expected price changes, etc., If these conditions change, the law will not hold good. Thus, the following exceptions to the law of demand may be indicated:-

(i) **Change in Taste or Fashion.** According to the law of demand, when price falls, demand is expected to increase. But if in the meantime consumer's tastes have undergone a change or if the commodity has gone out of fashion, more may not be demanded even if the price falls.

(ii) **Change in Income.** A rise in price is likely to result in a diminution of demand according to the law of demand. But if the consumer's income has gone up, he may be willing to buy more in spite of the rise in price.

(iii) **Change in Other Prices.** The law of demand says that if the price of a commodity, say tea, falls, more tea will be demanded. But if the price of coffee falls even more heavily, more tea may not be purchased; instead more coffee may be purchased. This is contravention of the law of demand.

(iv) **Discovery of Substitutes.** Acting on the la2w demand, India may lower the price of jute by polishing or reducing export duty to boost her sales of jute. But the discovery of cheap substitutes like paper bags may nullify our efforts and more jute may not be demanded even if the price of jute falls.

(v) **Anticipatory changes in prices** may also upset the law of demand. It is often seen that there is stockpiling of commodities and larger purchases even though the prices are rising. This may be due to the fact that either on account of the danger of war or widespread failure of rains, shortage is feared and the prices may in future go up still higher.

(vi) **The law of demand** does not hold good also when a commodity is such that its use confers distinction. In case of such a commodity, a fall in its price will keep off the eligible purchasers, because the use of a cheap commodity cannot be considered as a mark of distinction.

Conclusion. The above are a few exceptions to the law of demand. By and large, however, the law holds good. That is, a rise in price decreases demand and a fall in price increases it.

Cause of Changes in Demand

We spell out below some of the causes which bring about changes in demand and also explain how demand will be affected by the following factors:

Changes in tastes, preferences and fashion. We see that increasing habit of taking tea has decreased the demand for milk. Change in the mode of dress means a change in the demand for the dress materials. The fashion among ladies to keep hair long or short brings about changes in demand for hair - pins, hair - nets, etc.

Climate or weather changes. It is obvious that demand for a commodity must change with the change in season. In winter, there is a greater demand for warm clothing, for certain types of tonics and for coal or fuel. In summer, there is a great demand for electric fans, room coolers and cooling drinks, ice, etc.

Changes in the size and composition of population. It is not merely a change in the size of the consuming population but change in the composition of the population, too, which affects demand for certain commodities and services. In a country of increasing population, like India, where lakhs of children are born every day, there will naturally be demand for toys.

Changes in money supply. Where there is inflation, the additional money will add to the purchasing power of the community, and the prices will rise. But the rise of prices will not be uniform in the case of all goods. People will have to readjust their expenditure; demand for certain things will be reduced and for other stimulated.

Change in the price of the commodity. Obviously, demand is decisively affected by the change in the price of the commodity concerned. There is inverse relation between price and the quantity demanded. Lower the price, the greater is the demand, and vice versa.

Change in real income. A distinction is made between money income, i.e., the amount of money which a man may earn and real income which means the quantity of goods and services which he can buy with that amount of money. In times of can buy with that amount of money. In times of technical progress, there is a large output of cheap goods. The purchasing power of

money increases. Less money as it may be said, real income increases. Less money will be needed to purchase the same quantity of goods, and the saving so made will find outlet in the purchase of some other commodities. The demand schedules will have to be recast. Some goods may be eliminated from consumption and instead entirely new goods purchased; demand for some goods will decrease and that for others increase.

Change in the level and distribution of income. Through the instrument of public finance, e.g., by taxiing the rich and spending the funds so obtained on the poor. Wealth is redistributed. There is a transfer of spending power. This is bound to affect demand. Demands for those goods will increase which are purchased by a class whose spending power has increased, and vice versa. The larger is the average household income, greater is the demand for the commodities they consume.

Change in savings. Demand for goods is affected by a change in consumer's propensity to save. Large saving means less money available for the purchase of goods. The demand will therefore decrease.

Change in asset preferences. It is quite obvious that if a consumer develops marked liquidity preference, his demand for goods will decrease, because he prefers to keep with him ready cash instead of buying things.

Condition of trade. Demand for everything is greater in a boom even though the prices are rising. On the other hand, in times of depression, there is a general slackening of the demand.

Expectations or Anticipations. Expectations also bring about a change in demand. If prices are expected to rise in future, the demand for goods will increase now in the present. Similarly, expectations of rising incomes will restrain current purchases and postpone purchases to a future favorable situation.

Prices of Related goods. In case of substitutes, e.g., tea and coffee, an increase in the consumption of one will lead to a decrease in the demand for the other. When a decline in the price of one good results in a decline in the demand for another, they are substitutes. Or, two goods are substitutes if the demand for one is directly related to the price of the other.

In the case of **complements,** e.g., horse and carriage, increased demand for one will augment that for the other. Two goods are complements if the price of one and the demand for the other are inversely related. For instance, if the price of the carriages falls, the demand for horses rises. Other examples of complementary goods are pipes and tobacco, tennis rackets and tennis balls, etc.

In the case of **joint supply,** e.g., wheat and straw, the increased demand for one will lead to the cheapening of the other, and may, therefore, stimulate its demand too, after some time.

When there is a case of **joint demand,** the increase in the demand for the ultimate object, e.g., the house, will increase the demand for everything needed in building a house.

In the case of **composite supply,** e.g., light obtained from electricity, gas or kerosene, cheapening of any one of them will reduce the demand for the others.

In the case of **composite demand,** e.g., water required for drinking, washing, bathing, etc., any extension or contraction of its uses will correspondingly change the demand.

Thus, the demand for a commodity does not depend only on its own price but the prices of other goods too.

The limited supply of money that a consumer has is to be allocated among numerous goods that he has to purchase. Hence, the demands and prices of all goods are inter - related. A big price hike in certain commodities is bound to affect the demand for other goods that s consumer has to purchase.

These are some of the factors which bring about changes in demand.

Consumer Sovereignty

Price in a free market system are determined by demand and supply. Changes in consumers demand would cause prices to change and there by affect the allocation of resources. It is often said that in a free market society the consumers are sovereign. It is the consumer who guides and controls the market and accordingly decides what goods shall be produced and in what quantities and thus it is he who determines the allocation of resources. The free market system, therefore, give sovereignty to the consumer. The consumer places the orders, say for a particular type of shoes or clothes and the market simply carries out his order faithfully. The consumer gets what he wants. The producers or entrepreneurs are his bounded salves and so work as servants to carry out his commands.

But the consumer is not so sovereign as he is supposed to be. The most important check on his authority arises from the size of his income. The things do not move according to his wants unless it is backed by 'ability to pay'. The consumer may want pure ghee but he has to be content with Dalda for lack of mean to pay. The essential wants of poor consumer go unsatisfied under the market system for they are not backed by the purchasing power of money.

Besides, in a market system a individual consumer's demand does not count. It is only the collective demand of many consumers that rules.

Another strong check on consumer's power to control the market is the high pressure salesmanship and persistent advertisement which seek to modify the wants of consumer. The propaganda machinery is directed to mould and to control consumers' tastes.

Thus the actual world has traveled far away from the ideal situation of free competition among the producers and sovereignty of the consumer. The growth of giant corporations, big business and monopolies have radically changed the whole situation. Corporations or big businesses predominate the economies of the present - day capitalist countries and have greatly weakened the force of competition and restricted the sovereignty of the consumers. The giant corporations or big producers today do not merely "satisfy or fill" the wants of consumers; they themselves try to create these wants by massive expenditure on advertisement and propaganda to influence the public to buy the products they manufacture. Thus while the consumers still decide the allocation of resources among the goods to satisfy their "wants," these wants are themselves increasingly influenced by the producers. The advertisement expenditure by the producers or sellers has enormously increased in predominantly market economies.

NOTES

LESSON - 5

ELASTICITY OF DEMAND

Introduction

The law of demand explains the inverse relationship between the price and the quantity demanded. A fall in price leads to increase in purchases and an increase in prices lead to decrease in purchase. Thus, the law of demand only indicates the direction of change, on account of a change in the prices. It does not specify the rate at which the demand changes, in response to a change in the price.

The concept of the elasticity of demand, not only indicates the direction of change, but also the rate of change in the quantity demanded, in response to a change in the price. Thus, price elasticity of demand may be defined as the rate of change in the quantity demanded, in response to a given change in the price of a commodity. The price elasticity of demand can be calculated by the formula.

$$Ep = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}} \quad (Ep = \text{price elasticity})$$

Kinds of Elasticity

Depending upon the nature of the product, market conditions, type of consumers and other factors, the elasticity of demand for a product may be very high or very low. Based on the degree responsiveness of the quantity demanded to a change in price, elasticity of demand can be of five kinds.

Perfect Elastic

Here, the quantity demanded may increase, even when the price remains unchanged. Suppose that quantity demanded increases by 5%, even when there is no change whatsoever in the price, then the demand for the given product is said to be perfectly elastic. Thus theoretically, in the case of a product whose demand curve is perfectly elastic, consumers may be willing to buy infinite quantity of the product for a given price.

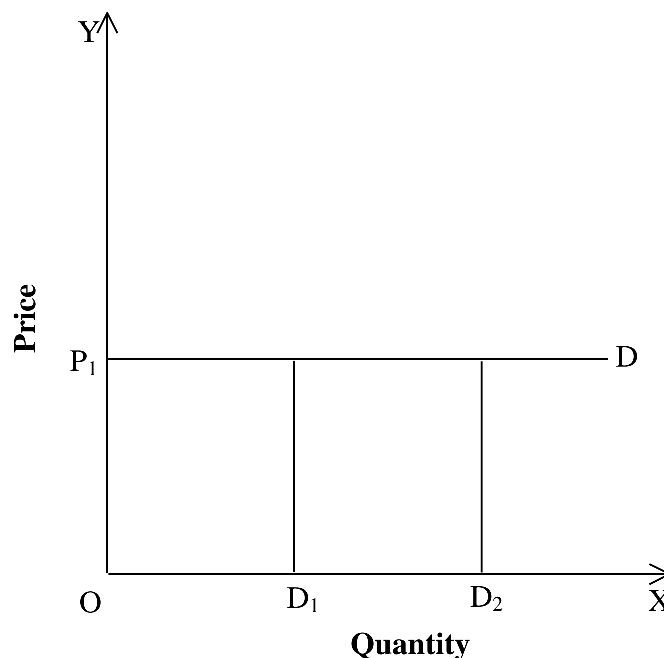


Figure 5.1

$$Ep = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}} = \frac{5\%}{0} = \text{infinity}$$

Products, which are perfectly elastic, are rare to find in reality. They exist only in theory. In the graph, for a given P1, quantity demanded is infinite. Elasticity of demand or e_p =

From the graph, it may be observed that, the change in quantity demanded can be infinite, even when the price remains the same. This is depicted by a demand curve DD, which is perfectly elastic, horizontal and parallel to the X-axis.

Relatively Elastic

Here the price elasticity of a product is greater than unity. When the proportionate change in demand is greater than the proportionate change in the price, then the elasticity may be greater than one and the product is said to be Relatively elastic.

Let us assume that the change in demand is 10%, but the change in price is only 5%. The Elasticity of demand is 2, i.e. 10/2 = 2. Thus Ep > 1.

From the graph it may be observed that the change in quantity demanded (Q_1 Q_2) is greater than the change in quantity demanded (P_1 P_2). The demand curve DD is more of less flat curve, indicating that, even a small change in the price, will have a tremendous impact on the demand.

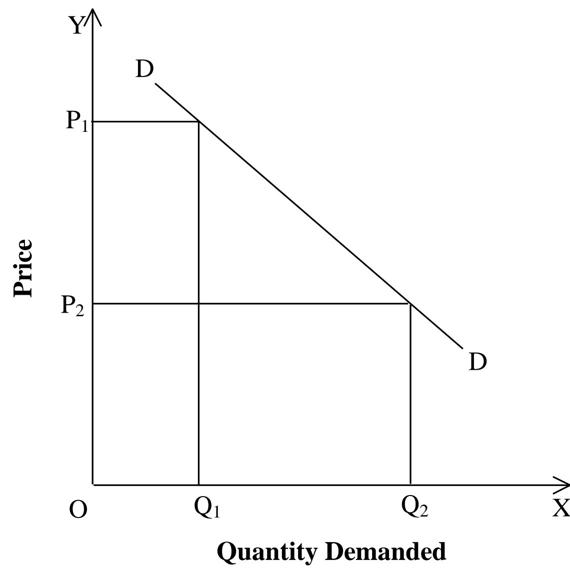


Figure 5.2

Unit elasticity of demand

Here, the proportionate change in the demand is equal to the proportionate change in the price. Ep = 1. Let us assume that the change in price 5% and the resultant change in demand is also 5% then Ep = 5% / 5% = 1

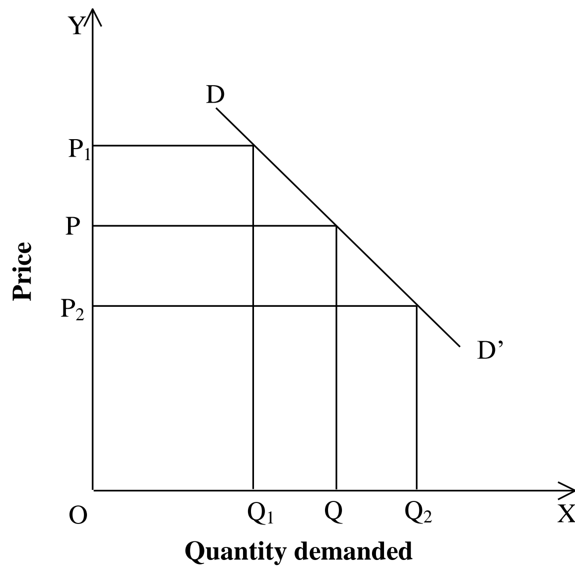


Figure 5.3

Perfectly inelastic demand

In this case, even a large change in the price does not bring about any change in the quantity demanded. In other words, the demand remains the same, irrespective of the changes in price level.

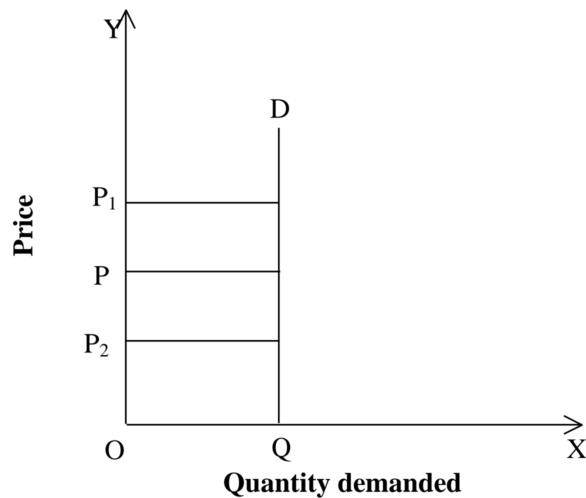


Figure 5.4

From the graph, it may be observed that a substantial change in price PP1, has brought about no change in demand. The demand curve, here is a vertical straight line, parallel to the Y-axis. The price elasticity, Ep, is thus, equal to zero.

Relatively inelastic demand

In this case, a big change in the price, bring about only a small change in the quantity demand. In the graph below, it may be observed that a big price change PP2 has lead to only a marginal increase in demand QQ2. Ep < 1. The demand curve DD1 is more or less vertical and it has a steep slope.

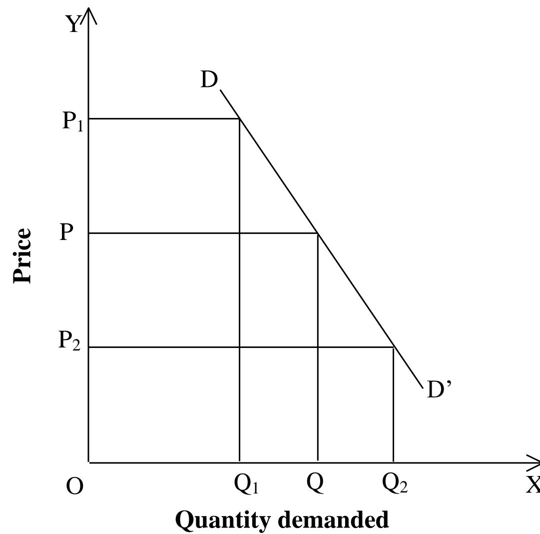


Figure 5.5

Factors Determining Elasticity of Demand

1. **Necessaries Inelastics:** For necessaries and conversational necessaries, the demand is inelastic; Example Salt, tobacco.
2. **Luxuries - Elastic:** For luxuries, demand is comparatively elastic, Example: Radio.
3. **Substitutes - Elastic:** For substitutes the demand is elastic: The demand for a commodity is said to be elastic if the commodity has substitutes. Example: Coffee and Tea
4. **Goods with Several Uses - Elastic:** Demand for goods having several uses in elastic Example: Coal
5. **Postponable Uses - Elastic:** Demand for goods the use of which can be postponed is elastic Example: Umbrella.
6. **Level in Prices:** Elasticity also depends on the level of prices. If the price is either too high or too low, the demand will be inelastic. Examples: Diamonds, safety pins.
7. **Proportion of Consumer's Income Spent on the Commodity:** The proportion of total expenditure devoted to a commodity is small, the demand for it tends to be inelastic. Example: Proportion of expenditure on ink is quite small and consequently the demand for this is inelastic.
8. **Habit and Fashion:** Demand for those goods which are habitually consumed or which are in fashion is inelastic. Example: Particular brand of a cigarette.
9. **Time:** Elasticity varies with the length of time periods. In the larger period of time, demand is more elastic. In the short period of time, demand is less elastic or inelastic.

Measurement of Elasticity Demand

A manager who wishes to take pricing decisions may be keen on measuring the price elasticity of demand for the product that he produces. This is important because it enables him to know, what would be the change in demand, if he were to effect a change in the price. The graphical depiction of the elasticity of demand gives an approximate picture. In order to know the exact change in demand as a consequence of a change in the price, it is important to measure the elasticity of demand for the given product. Alfred Marshall, the economist who gave the concept of elasticity of demand, has also elaborated on three methods, through which elasticity of demand could be measured. The three different methods are a) Outlay method b) Point or geometric method c) Arc method.

Outlay Method

Under this method, we measure the outlay or the expenditure incurred on the product to obtain a measure of the elasticity of demand. Price Elasticity of demand for a product can be greater than one, equal to one or lesser than one, depending upon the expenditure incurred in response to changes in price.

1) Price elasticity of demand is greater than one (Ep > 1): When the expenditure incurred on a given product increases in response to a decrease in price, then the elasticity of demand is said to be greater than one. The example illustrate the case.

Price (Rs.)	Quantity (Q)	Expenditure	Ep
20	5	100	
16	8	128	Ep > 1.
10	14	140	

Price elasticity is equal to one (Ep = 1): When the expenditure incurred on a given product remains unchanged in response to a decrease in the price of the product, then the price elasticity of the given product equals (Ep = 1). The example illustrates the case.

Price (Rs.)	Quantity (Q)	Expenditure	Ep
20	4	80	
16	5	80	Ep = 1.
10	8	80	

Price elasticity is less than one (Ep < 1): When the expenditure incurred on a given product decreases in response to a decrease in the price, then the price elasticity of the product is lesser than one, or the product is relatively price inelastic Ep < 1. The example illustrates the case.

Price (Rs.)	Quantity (Q)	Expenditure	Ep
20	3	60	
16	3.5	56	Ep < 1.
10	5	50	

In all the three cases, it may be noted that, the demand nevertheless increases in response to a decrease in the price. However, the rate of change in the demand, in response to a decrease in the price, is different in the three cases. In the first case, the expenditure incurred increases. The increase in the quantity demanded in response to a change in the price is significant, so much so that there is an increase in the expenditure incurred on the product.

In the second case, the increase in demand is apparent but the increase is not significant enough to bring about an increase in the expenditure incurred on the product. The expenditure incurred on the product remains the same just as it was before the decrease in the price.

In the third case, the increase in the demand is so marginal that there is actually a decrease in the expenditure incurred. The three cases, which show the impact of price on expenditure, have been depicted graphically in Figure 5.6

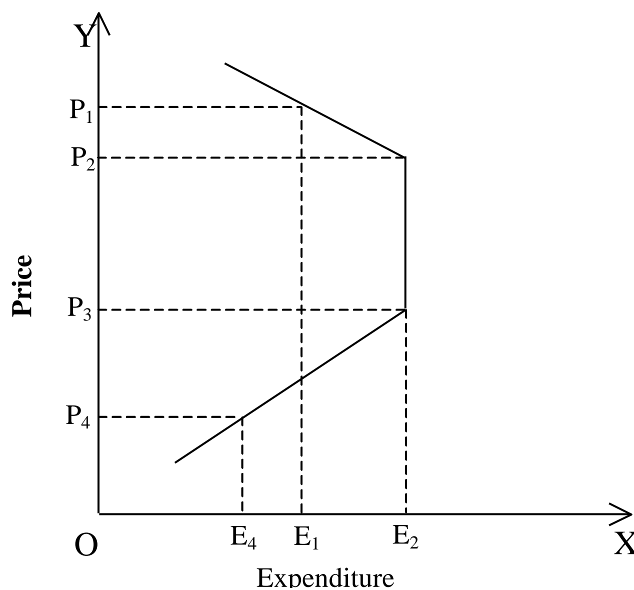


Figure 5.6

In the graph, the total outlay or expenditure is measured on the X axis and price is measured on the Y axis. When price falls from P1 to P2, the expenditure incurred increases from E_1 to E_2. Therefore, this is a case where the price elasticity of demand is greater than one (Ep>1). When price falls from P_2 to P_3, the expenditure remains the same and therefore, this is a case of unitary elasticity (Ep =1). When price falls from P_3 to P_4, we notice that the expenditure actually decreases and therefore, this is a case where the elasticity of demand is less than one (Ep<1).

This method, which is called Total outlay method, Revenue method or Expenditure method, classifies demand into three types. It does not enable us to measure the elasticity of demand accurately in numerical terms. Nevertheless, it is an approximate measure of the elasticity of demand.

Point Method or Geometric Method

A Geometrical way of measuring the elasticity at any point on a demand curve has also been illustrated by Alfred Marshall. Consider the straight - line demand curve in the Figure below. For any point P on the demand curve the price elasticity of demand can be illustrated as follows.

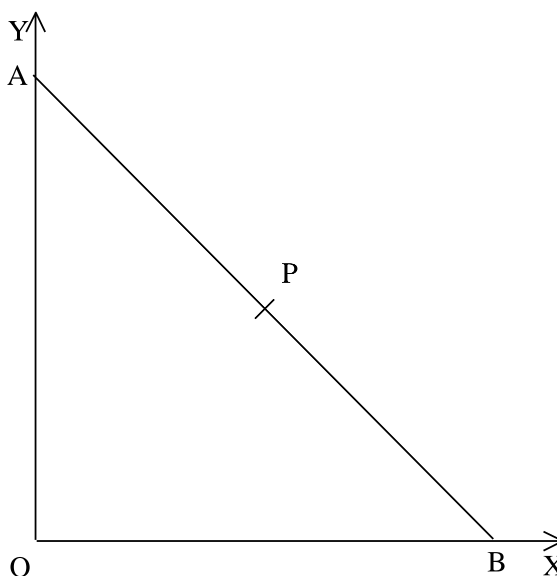


Figure 5.7

The demand curve is extended to meet the two axes. P divides the demand curve into two segments.

$$Ep = \frac{\text{lower segment of the demand curve}}{\text{upper segment of the demand curve}} = \frac{PB}{PA}$$

If the demand curve is not a straight line, the same method may be used by drawing a tangent to the curve at the required point. Thus, for the non - linear demand curve illustrated below, a tangent line AB is drawn at point P on the demand curve.

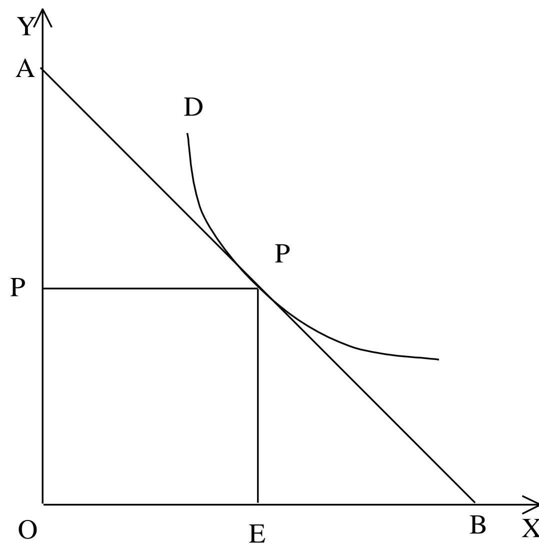


Figure 5.8

Applying the same formula the point elasticity of demand can be measured as follows.

$$Ep = \frac{\text{lower segment of the tangent line}}{\text{upper segment of the tangent line}} = \frac{PB}{PA}$$

It should be noted that for any demand curve, elasticity of demand may vary at different points. This can be illustrated by the graph below.

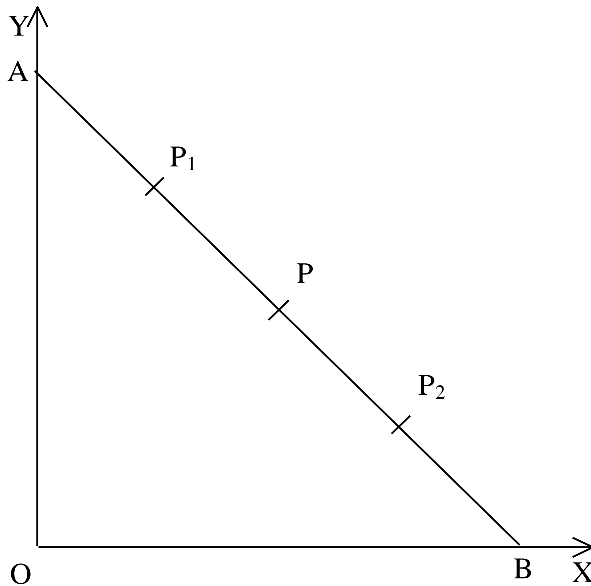


Figure 5. 9

In the graph, there are three points. The first point P_1 is at the upper end of the demand curve. The second point P_2 is at the centre of the demand curve, dividing the demand curve into two equal segments. The third point P_3 is at the lower end of the demand curve. When the demand curve is extended to the axis, we obtain a demand curve AB.

Thus elasticity of demand at point $P_1 = P_1B / P_1A$. At this point $Ep > 1$.

Thus elasticity of demand at point $P_2 = P_2B / P_2A$. At this point $Ep = 1$.

Thus elasticity of demand at point $P_3 = P_3B / P_3A$. At this point $Ep < 1$.

Arc Elasticity

The student has so far studied two different methods that give only an approximate measure of the elasticity of demand. The Expenditure method and the point method give only an approximate measure of price elasticity. Moreover, the point method give different results for the same change in the price. The 'Arc Method' for measuring price elasticity of demand, on the other hand gives the result in numerical terms and is more accurate.

$$Ep = \frac{\dfrac{\text{original quantity - new quantity}}{\text{original quantity + new quantity}}}{\dfrac{\text{original price - new price}}{\text{original price + new price}}}$$

Types of Elasticity

We may distinguish between the three types of elasticities, viz., Price Elasticity, Income Elasticity and Cross Elasticity.

Price Elasticity

Price elasticity measures responsiveness of potential buyers to changes in price. It is the ratio of percentage change in quantity demanded in response to a percentage change in price.

Income Elasticity

Income Elasticity is a measure of responsiveness of potential buyers to change in income. It shows how the quantity demanded will change when the income of the purchaser changes, the price of the commodity remaining the same. It may be defined thus: The Income Elasticity of demand for a good is the ratio of the percentage change in the amount spent on the commodity to a percentage change in the consumer's income, price of commodity remaining constant. Thus,

$$\text{Income Elasticity} = \frac{\text{Proportionate change in the quantity purchased}}{\text{Proportionate change in Income}}$$

while prices remain constant.

It is equal to unity or one when the proportion of income spent on a good remains the same even though income has increased.

It is said to be greater than unity when the proportion of income spent on a good increase as income increases.

Generally speaking, when our income increases, we desire to purchase more of the things than we were previously purchasing unless the commodity happens to be an "inferior" good. Normally, then since the income effect is positive, income elasticity of demand is also positive.

It is zero income elasticity of demand when change in income make no change in our purchases, and it is negative when with an increase in income, the consumer purchases less e.g., in the case of inferior goods.

It may be carefully noted that for any individual seller or firm, the demand for the product is highly elastic even though the demand for the product as a whole may be inelastic. By lowering he price, as compared with his rivals, the seller can infinitely increase the demand for his product. The demand curve will thus be a horizontal line.

Both elasticities, viz., price elasticity and income elasticity, are valuable aids in the measurement of demand for different commodities. As much they are also helpful in measuring the incidence of taxation.

Cross Elasticity

Here, a change in the price of one good causes a change in the demand for another. Cross - elasticity of Demand for X and Y

$$= \frac{\text{Proportionate change in purchases of commodity X}}{\text{Proportionate change in the price of commodity Y}}$$

This type of elasticity arises in the case of inter - related goods such as substitutes and complementary goods.

Practical Importance of Elasticity of Demand

1. It guides the businessman in fixing the prices of his goods. If the demand for a commodity is elastic, he can raise the price. If it is elastic, he has to bring down the price.

2. The finance Minister has to keep in mind the elasticity of demand for a commodity before imposing a tax. The finance minister must levy tax on such commodities, for which the demand is less elastic.
3. The government has to take into account the elasticity of demand for a product, before imposing price control on it.
4. In the case of joint product, separate cost or productions of the two commodities are not ascertainable. In such cases, price of each will depend on the elasticity of demand of each. Example : Paddy and straw.
5. The transport authorities also fix the prices for their various services after considering the elasticity of demand.
6. It is used in the calculation of terms of trade. It is possible to calculate the terms of trade between countries only by taking into account the elasticities of demand.
7. Elasticity can influence wages. If demand for a particular type of labour is inelastic, the trade unions can easily get their wages raised.
8. The rates of exchange between currencies are fixed depending on the elasticity, of demand for currencies in the exchange market.

NOTES

LESSON - 6

DEMAND FORECASTING

Meaning of demand forecasting

Future is unknown and uncertain. However, managers have to make plans for future levels of production in the present. It always takes time for building up productive capacity to produce a product. Machines have to be ordered and installed, the required skilled labour has to be employed and trained, funds have to be arranged for fund production. If the future demand for the product is not known in advance proper planning for future production cannot be done. Thus, managers have to operate in uncertain environment. To reduce this uncertainty in planning for future production levels demand forecasting is essential. Forecasting demand means prediction of future demand. Forecasting of future demand is one of the most importance functions of managers of firms. Good forecasting of demand, reduces uncertainty of environment in which business decisions are made. If the future was known with certainty of would not be required. If there is a certainty about future demand, decision about proper level of production could be taken on a once-for-all basis and no revision of it would be required. However, uncertainty is a fact of life and, therefore, a good forecast of future demand is necessary if proper planning for future level of production is to be made.

Good forecasting of future demand is also important for calculating rate of return on capital investment. Capital investment yields over a number of years in future. It is by comparing rate of return on capital investment with the current rate of interest that decision regarding investment is taken. Further, the demand for firm's output depends on the price of tits product, prices of competing products, incomes of the people and advertisement expenditure by a firm to promote its sales. If the demand forecast of a firm reveals that the demand for its product is not enough it can think of stepping up expenditure on advertisement to raise its market-share (that is, its share in the total market demand for the product). Further, to raise demand of its product or its market share, a firm can pursue other strategies such as properly adjusting its price policy or model of its product.

Demand forecasting for a product may be in respect of (1) aggregate demand, that is, total demand for output in the economy at a future time. (2) Total demand for the product of an industry and (3) the demand for the product of an individual firm. As regards aggregate demand, it is usually measured by the level of gross national product (GNP). However, an individual firm is more interested in forecasting demand for its own product or its market share rather than gross national product.

Need of demand forecasting

Demand forecasts are needed not only by established firms but also by the new firms, who are planning to enter an industry. If they think the demand for the product is large enough, it will decide to produce the product and thus enter the industry, inadequate demand forecast for the product will prevent the entry of firms in the industry. Moreover, established firms may be interested in predicting demand for a new product which they will be launching. It will forecast demand for the new product by taking expenditure it wishes to make on it and overall future level of economic activity (i.e., level of income).

Importance of demand forecasting

Demand forecast plays an important role in planning for future level of production, for launching a new product, for expanding production capacity (i.e., making further capital investment) and for entering an industry. This helps a manager to acquire the needed plant and capital equipment, the quantity of required raw materials, the necessary skilled labour and other type of human resources. There can hardly be any capital investment or planning for future production if uncertainty prevails about the likely demand for the product. Therefore, forecast of demand greatly helps in business decisions by reducing uncertainty under which firms operate.

Types of demand forecasting

Based on the time span, Demand forecasting can be for the immediate short term or the long term. Short term demand forecasting is limited to short periods, say, 3 months to one or two years. Such forecasts are made to plan production, purchases and arranging for finance, for the immediate future. If a scarcity of raw materials or spares is anticipated, immediate purchases of the same have to be made. They also help a firm to give shape it's sales and distribution policies.

Long term forecasting enables a firm to forecast the long demand for it's product. In order to be successful, a firm should be well prepared to face the distant future. If an increase in demand is anticipated, the firm may have to expand it's plant capacity, increase the purchase of machinery and fixed equipment. A multi product firm must take into consideration, the future demand conditions of the various products it produces. It is also important for the firm to take into consideration, the level of competition, the activity of competitors, the price of conditions in the future and other macroeconomic factors. Long-term forecasts, however, may not be as accurate as short term forecasts. Demand forecasting may also be undertaken at three different levels- firm level, industry level and economy level.

Firm level

This refers to demand forecasting for a micro entity, i.e. the firm's products. Any individual firm may be interested in knowing the demand for it's product in the future. This is necessary for decision making and forward planning. TELCO, for instance would have to forecast in advance the demand for 'INDICA', taking into consideration the overall environment for the car industry in general, small cars particularly, the possible introduction of new brands into the small car segment, the government's policies and a host of other factors.

Industry level

Here the forecasting of demand is for the industry as a whole. This kind of forecasting may be done by certain firms belonging to the same industry or by industry associations like cement manufacturers association, automobile manufacturers association or Chambers of commerce and other research agencies.

Economy level

Here the demand forecasting is done for the economy as a whole and is based on Macro level parameters like national income, national expenditure, change in political environment, change in consumption habits, entry of multinational and transnational companies, global changes and their impact on the Indian economy, prediction of favourable or unfavourable monsoons and a host of other factors.

Objectives of demand forecasting

Demand forecasting has the following objectives:

1. To formulate suitable production policy so that there may not be any over-production or under-production.
2. To formulate proper price policies so that the level of price does not fluctuate too much in the periods of Depression or inflation.
3. To reduce costs of raw materials and control inventories (i.e., to stock enough raw material according to demand estimates)
4. To arrange for short-term financial requirements, such as working capital for day-to-day requirements.
5. To set sales targets based on demand estimates and provide incentives to sellers.
6. To arrange for promotional efforts, such as advertising and sales campaigns, etc.

7. To help the management to access the suitable labour requirements so as to ensure the best labour facility in the production process.

Factors involved in demand forecasting

Before we attempt to apply the methods and techniques of forecasting, we should consider the relevance of the following factors which involved in demand or sales forecasting:

1. Time period forecast
2. Level of forecast
3. Nature of forecast

1. Time period forecast

It covers both short-term forecasts and long-term forecasts. Short-term forecasts cover any period upto one year, since policy changes pertaining to taxation, sales promotion, etc., can not be predicted for more than a year. But long-term forecasts cover a period upto 15 years; the future becomes so uncertain that the predict9ion becomes doubtful.

2. Level of Forecast

It refers to a demand or sales forecast under-taken at different levels-macro level, industry and firm level.

At the **macro level,** forecasting deals with the general economic conditions, and is measured by the index of industrial production, national income, employment or expenditure.

At the **industry level,** for example, the product of automobiles are particularly interested in changes in the age composition of the population and the extent of changes in the consumer installment debt because these factors have a considerable effect on the sales of automobiles.

At the **firm level,** the management is mostly interested in evaluating the impact of its own actions and the effects of outside forces on demand.

3. The nature of Forecast

It is an equally important factor which influences the demand forecasting. The forecast may be either general or specific. A general forecast gives the global environment in which the business operates. Many firms adopt a mix of both because too much generalization obscures the real picture and too little provides insufficient basis for planning and execution.

General approach to demand forecasting

There are four distinct steps in dealing with any demand forecasting problem. They are as follows:

1. Identity and clearly state the objectives of the forecasting problem.

2. Ascertain the determinants of demand for the product or product group, pertaining to consumer's non-durable, consumer's durable and capital goods.
3. Select appropriate methods of forecasting so as to obtain the best result.
4. Prepare the forecast and interrupt the findings.

The focus of the foregoing approach has been on the total demand for an product or product group. Once a product forecast has been made for the whole industry, the company will be interested in estimating the share of the market that it can get. However business forecasting calls for a flexible approach on the part of the analyst and the management.

There are two approaches to the problem of demand forecasting for established products.

1. To obtain information about the intentions of buyers through collecting experts opinion or by conducting interviews with consumers.
2. To use past experience as guide and by extrapolating past statistical relationships to suggest the level of future demand.

Methods of demand forecasting

There are several methods which can be used to forecast future demand for the products. The following are some of the important alternative techniques used for forecasting demand:

1. Consumer Survey Method
2. Expert Opinion
3. Market Experiments
4. Time Series Analysis
5. Econometric Method

We shall explain below these alternative techniques of forecasting demand.

1. Consumer survey Method

A direct method to obtain information future demand for gods is to conduct a survey, surveys are important technique for short-term forecasts. If data from existing sources do not meet their requirements or are not available, the firms conduct their own survey. This changes in the existing product. Surveys generally involve use of conducting consumer interviews or sending mailed questionnaire asking consumers their intentions or plans demand for goods.

There are two types of surveys

(1) Complete enumeration and

(2) Sample survey

Complete enumeration

Just like population census in this all consumers of a product are asked questions about quantity of a product they plan to buy in future if the price of the good is increased, say by 10 percent. With the information so gathered regarding of all consumers to buy a commodity, total demand for the product and changes in it resulting from changed n price can be estimated.

The chief merit of this method of complete enumeration is that it is free from any bias or value judgement of the investigator. The investigator simply records the data or information. But it is very costly, tedious and cumbersome process. Therefore, it cannot be applied when a larger number of consumers are involved.

Sample Survey Method

In this sample survey method, only a few consumers are selected at random or on a stratified basis. Through personal interviews or mailed questionnaire, questions are asked from them about their intended demand for a product and their response to changes in price of the product, their incomes, price of competing products. The data so collected is classified and tabulated for analysis of consumers' demand.

2. Expert Opinion Method

An alternative method of demand forecasting is to obtain views of specialists who are well-informed about the market possibilities of a product. These specialists or experts may be of the organization or firm itself. For example, the executives and sales managers of the firm may be asked to estimate future market possibilities of a product. There may be outside experts such as consultant firms, investment analysts, who are professionally trained for the purpose of forecasting demand. Although predictions of demand by experts are not always based on any hard data but they can provide useful information about demand for the product. There are various methods of confirming the opinion regarding future demand by experts. One such method id Delphi technique which we explain below:

Delphi Technique

In Delphi technique opinion of a number of experts about future demand is first obtained. Then, each expert is told about the prediction of the other experts and asked in the light of the other's views whether he would revise his prediction about future demand. The experts are again shown each other's revised forecasts and asked to reconsider their forecasts further till a consensus

is reached or until referring the opinion of others again to the experts result in little or no change in demand forecasts.

Survey of Sales Force

When it is very costly or otherwise not possible to conduct complete enumeration or a sample survey of consumer's intentions or seek expert opinion about future demand, a firm may enquire from its sales-representatives or salesman about their estimates of sales of its product in future. Thus, in this method information regarding likely sales is obtained from those who are closest to the market and have a intimate insight of the market. The responses of the various salesman or representatives are then aggregated to arrive at total demand forecast for the product.

This method has many advantages. It is cheap and easy to do. It has further advantage of increasing the motivation of salesman to achieve the self-selected target for which they had made a forecast when they were asked to provide their prediction for future sales.

3. Market Experiments

Business firms can also make market experiments to forecast demand for their products especially when they make changes in price, advertising expenditure, or to introduce a new product in the market. A big problem with the survey technique of demand forecasting explained above is that consumer responses in the survey may not correspond to actual consumer behavior. That is, consumers do not necessarily behave in the way they say when surveyed. This problem ac be partly overcome by the use of market experiments. The two types of market experiment are generally used: (1) Test Marketing and (2) Controlled Experiments.

Test Marketing

In this technique the first step is to select a particular test area which accurately represents the whole market in which the new product is to be launched. Thus market area for testing may consist of several cities and town, or a particular representative region of the country or a sample of consumers' taken form a mailing list.

Controlled Experiments

An alternative type of market experiments is controlled experiments which are conducted to test the demand for a new product by a firm or to test the demands for various brands of a product. In a controlled experiment, a sample of some consumers of a product which are representative of the target market is selected. They are asked to visit a shopping store of a firm where various brands of a product are placed for sale. These visiting consumers are

asked which and how much of each brand they would by at different prices. Their preferences are recorded. They are then provided advertising materials for various brands. Now, the selected samples of consumers are given certain fixed money and asked to make purchases of the products or various brands of a product. The quantity of the product or particular brands of a product purchased by them is recorded. A questionnaire may also be prepared to ask the reasons for the particular choice they have made. The price of the product or its model may be changed and the experiment is repeated.

4. Time series analysis

Time series analysis is an important technique of forecasting demand which is widely used by business world. As shall be explained below, time series analysis contains more than one technique of forecasting of time series analysis uses only past or historical values of a variable to predict future values. It may be noted that the time-series analysis does not attempt to explain the casual relationship between variables that determine future value of a given variable.

1. Trends

These are long-term increase or decrease in time series of a variable (i.e., demand or sales of product in the present analysis of demand forecasting). For example, increasing population over time or changing consumers tastes may result in long-term increase or decrease of a demand for a product over time.

2. Seasonal variations

These are the changes in demand series over time due to changes in seasons during a year. Seasonal effects are generally consistent from year to year.

3. Cyclical variations

These are substantial expansion or contraction in an economic variable (demand or sales in the present analysis) that are usually more than a year's duration. In cyclical variations in an economic series sustained periods of high values of variable are followed by its low values. In most industries cyclical changes in demand are not consistent or predictable over time. It may be noted that cyclical variations in a variable caused by different types of factors.

5. Econometric method

Another important forecasting technique used by the managerial economist is the econometric model. Econometric is the use of statistical methods and economic theory to estimate the casual relationship between economic variables. On the basis of economic theory a mathematical model describing relationship between economic variables is established. Then

through the use of statistical methods estimates of parameters are made. With the help of these parameters forecasting of demand is made. Econometric technique has a number of important advantaged over time-series analysis, survey technique, except opinion or sales force polling and barometric methods. The most important advantage of econometric model is that it not only enables us to forecast an econometric phenomenon but also explains it. That is, it establishes casual relationships between economic variables.

Forecasting demand for a new product

Joel Dean has suggested six approaches for forecasting demand for a new product.

1. Evolutionary approach

Under this method the demand for a new product is estimated on the basis of an existing old product. For example, the demand for colour TV is based on the demand for Black and White TV sets. This approach is useful only when product is close to the old product or an improvement over the existing product.

2. Substitute approach

Under this method, the demand for a new product is analyzed as a substitute of the old product. The demand for cell phones can be studied as a substitutes for telephones.

3. Growth curve approach

Under this method, it is assumed that the growth trend of the new product would be similar to that of an existing product. For example by analyzing the past growth trend of cycles in general, the growth trend of a new cycle brand can be predicted.

4. Opinion approach

Here the consumers are directly interviewed and information pertaining to their opinions and purchase intentions are obtained.

5. Sales experience approach

Here, the product is actually introduced in the market (say, a departmental store, super market) and the reaction of the consumers, is observed. Under this method, interpretation can be made only after taking into consideration the peculiar characteristics of the sample market.

6. Indirect approach

Under this method, the opinion of specialized dealers of similar products are obtained.

Features of Good Forecasting Method

1. Accuracy

The method of forecasting should give accurate results. If the results of the research form the basis of various managerial decisions, it should be reliable and accurate.

2. Simplicity

The method should not involve complicated Mathematical and econometric models and should be easily understood. The chances of errors are high, if the method gets complicated.

3. Economy

The method employed should produce a accurate results with minimum cost.

4. Time

Time factor is very important, because, if the forecast takes a very long time, it will not only be expensive, but the results of the forecast may lose it's utility.

5. Flexible

The method should be as flexible as possible, so as to accommodate any characteristic environment that may take place with future.

6. Easily available

The method should be such that the date required are easily available.

NOTES

LESSON - 7

BUSINESS CYCLES - TYPES AND PHASES

Definition of Business cycles

In the words of W.C. Mitchell, "Business cycles are a species of fluctuations in the economic activities of organized communities. The adjective 'business' restricts the concept of fluctuations in activities which are systematically conducted on a commercial basis. The noun 'cycles' bars out fluctuations which do not recur with a measure of regularity." Prof. Mitchell, thus, insists upon a measure or regularity in cyclical fluctuations.

The business cycle, in short, is an alternate expansion and contraction in overall business activity, as evidenced by fluctuations in measures of aggregate economic activity, such as, the gross product, the index of industrial production, and employment and income.

Characteristic of Business Cycle

From the definitions given above we can gather the features of business cycle.

(i) It occurs periodically

The business cycle occurs periodically in a regular fashion. This means the prosperity will be occurring alternatively.

(ii) It is all embracing

The business cycle implies that the prosperity or depressionary effect of the phase will be affecting all industries in the entire economy and also affecting all industries in the entire economy and also affecting the economies of other countries. It is international in character. The Great Depression of 1929 is an example of this.

(iii) It is wave-like

The business cycle will have a set pattern of movements which is analogous to waves. Rising prices, production, employment and prosperity will become the features of upward movement: Falling prices, employment will become the features of the downward movement.

(iv) The process is cumulative and self-reinforcing

The upward movement and downward movement are cumulative in their process. When once the upward movement starts, it creates further movement in the same direction by feeding on itself. This momentum will persist till the forces accumulate to alter the direction and create the downward movement. When downward movement starts, it persists in the same direction leading to

the worst depression and stagnation till it is retrieved to gain an upward movement.

(v) The cycles will be similar but not identical

Different cycles and waves in the business cycles will be similar in general feature, but they are not identical in all respects. "A typical cycle constructed by making, as it is were, a composite photograph of all the recorded cycles would not materially differ in form very widely from any one of them. But this typical cycle is not an exact replica of any individual cycle. The rhythm is rough and imperfect. All the recorded cycles are members of the same family, about among them are no twins".

Types of business cycles

Prof. James Arthur Estey has classified business cycles under the following heads:

1. Major and Minor Cycles

Major cycles may be defined as the fluctuations of business activity occurring between successive crises. The term "crisis" may be interpreted here to mean the major "breakdowns" or "downturns" that interrupt from time to time the relatively even tenor of economic activity. So the major cycles constitute the intervals between successive major downturns of business activity or between major recessions. On this basis, Prof. Hansen recognizes twelve major cycles in the U.S.A., during the period from 1837 to 1937, with an average duration of 8.33 years. The major cycles are sometimes referred to as Juglar Cycles, after the name of Clement Juglar, a French economist of the nineteenth century, who on the basis of his investigation, established the crystal nature of business fluctuations.

It has been established from the records of business fluctuation s that each major cycle is made up of two or three minor cycles the upswing of business in the major cycle is often interrupted by minor downswings, likewise, the downswings of business in the major cycle may be interrupted by minor upswings. These shorter cycles in major cycles are sometimes referred to as minor cycles. The duration of the minor cycles averages close to 40 months. These minor cycles have actually operated both in Great Britain and the U.S.A. Since the distinction 'between major and minor cycles was observed by Prof. Joseph Kitchin, the minor cycles are sometimes referred to as Kitchin Cycles.

2. Building cycles

This refers to the cycle of building construction. The duration of the building cycles is longer than that of the business cycle.

It has been discovered the building industry is also subject to fluctuations of fairly regular duration. There are upswings and downswings in the building cycles is 18 years-just twice the length of business cycle. Between 1830 and 1934, there were six complex building cycles in the U.S.A.

3. Kondratieff Cycles (or Long Waves)

They are sometimes referred to as "long waves" occurring in a 50 or 60-year cycle. The long waves in economic activity were discovered by the Russian economist, Kondratieff. Hence, these long waves are called Kondratieff Cycles. Kondratieff, on the basis of statistical data pertaining to the period 1780-1920, was able to establish 21/2 long cycles in England and France each full cycle being of the duration of 60 years.

Summing up, the fundamental changes in economic activity include three kinds of cycles-the short or minor or the Kitchen cycles of the duration of 40 months or so, the major or the Juglar cycles, composed of three minor cycles and of the duration of 10 years or so, and finally, the Kondratieff cycles (or, long waves), made up of 6 Juglar cycles and of the duration of 60 years.

Phases of Business Cycle

A typical or standard business cycle is characterized by five different phases or stages-depression, recovery (or, revival), prosperity (or, full employment), boom (or, overfull employment), and recession.

Depression

This constitutes the first stage of a business cycle. It is a protracted period in which business activity in the country is far below the normal. It is characterized by a sharp reduction of production, mass unemployment, low employment, falling prices, falling profits, low wages, contraction of credit, a high rate of business failures and an atmosphere of all-round pessimism and despair. A decline in output or production is accompanied by a reduction in the volume of employment. All construction activities come to a more or less complete standstill during a depression. The consumer-goods industries, such as, food, clothing, etc. are not so much affected by unemployment as the basic capital goods industries. The prices of manufactured goods fall to low levels. Since the costs are "sticky" and do not fall as rapidly as prices, the manufacturers suffer huge financial losses. Many of these firms have to close down on account of accumulated losses.

Recovery (or, Revival)

It implies increase in business activity after the lowest point of the depression has been reached. During this phase, there is a slight improvement in economic activity, to start with. The entrepreneurs being to feel that the

economic situation was, after all, not so bad as it was in the preceding stage. This leads to further improvement in business activity. The industrial production picks up slowly and gradually. The volume of employment also steadily increases. There is a sow, but sure, rise in prices, accompanied by a small rise in profits. The wages also rise, though do not rise in same proportion in which the prices rise. Attracted by rising profits, new investments take place in capital goods industries. The banks expand credit. The business inventories also start rising slowly. The pessimism and despair of the preceding period is replaced by an atmosphere of all-round cautious hope.

Prosperity (or, Full Employment)

This stage is characterized by increased production, high capital investment in basic industries, expansion of bank credit, high process, high profits, a high rate of formation of new business enterprises and full employment. There is a general feeling of optimism among businessmen and industrialists.

The longest sustained period of prosperity occurred in U.S.A. between 1923 and 1929 with some minor interruptions in 1924.

Boom (or, Overall Employment)

It is the stage of rapid expansion in business activity to new high marks, resulting in high stocks and community prices, high profits and overall employment.

The prosperity phase of the business cycle does not end up with a stable state of full employment; it leads to the emergence of boom. The continuance of investment even after the stage of full employment results in a sharp inflationary rise of prices. This causes undue optimism among businessmen and industrialists who make additional investments in the various branches of the economy.

Recession

The feeling of over-optimism of the earlier period is replaced now by over-pessimism characterized by fear and hesitation on the part of the businessmen. The failure of some business creates panic among businessmen. The banks also get panicky and begin to withdraw loans from business enterprises. More business enterprises fail. Prices collapse and confidence is rudely shaken. Building construction slows down and unemployment appears in basic, capital goods industries. This capital unemployment then spreads to other industries. Unemployment leads to fall in income, expenditure, prices and profits. The recession, it should be remembered, has cumulative effect. Once a

recession starts, it goes on gathering momentum and finally assumes the shape of depression-the first phase of the business cycle complete.

In this Diagram, PM is the full employment i.e, Above this line, we have two stages of the business cycle-a boom in the upswing and precession in the downswing. Below this line, again, we have two stages of business cycle-recovery in the upswing and depression in the downswing. The business cycle, as shown in the diagram, passes through five stages. It starts with depression to be followed by recovery, prosperity, boom, recession and ultimately ends up again with depression.

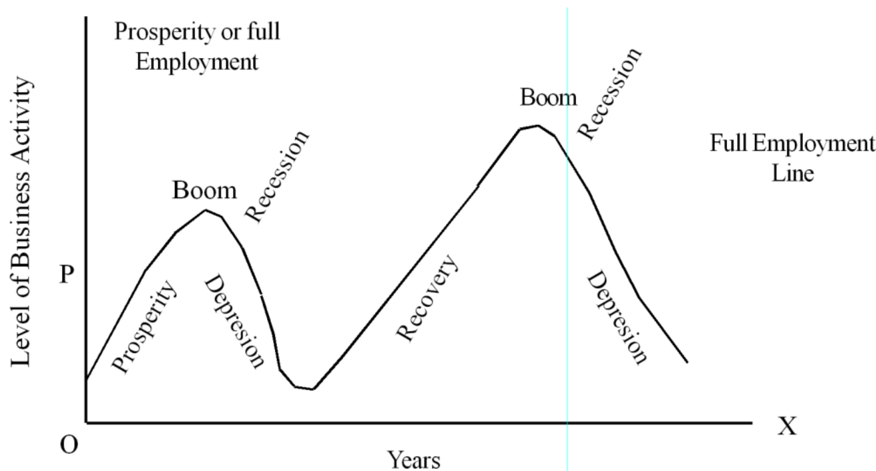


Fig 7.1

These are the five phases or stages of a typical business cycle. It does not, however, imply that every business cycle passes through these five stages in the same order. It is possible tat the recovery stage may be followed by the recession stage without the business cycle entering into the prosperity and boom stages, as it actually happened at U.S.A., in 1937.

NOTES

LESSON 8
MARKET STRUCTURE

Introduction

Many economic and legal factors combine to create the environment in which a firm must operate. These include government policies towards growth of business, potential economics from large-scale production, and the geographical dispersion of concentration of potential buyers for output, the blend to create market structure. Economists, therefore, classify industries or groups of firms into several categories on the basis of certain criteria, mainly the nature of competitive conditions.

The competitive structure of the market makes it aptly clears whether the decision variable for management in a particular situation would be prices or output or both. In a situation where there are large numbers of buyers or sellers, any firm will have to sell its commodity at the prevailing market price and control will be limited only to the level of output to be produced and sold. On the other hand, if there is some element of monopoly present in the market and output.

The knowledge of market structure within which a firm is to operate is very helpful in understanding the nature and extent of maneuverability, which the firm has in deciding about the price and quality of the product.

The Market and the Criteria for Market Classification

Different economists have tried to define the market, as they perceive it as is obvious from their statements given below:

According to Sidgwick, "A market is a body of persons in such commercial relations that can easily acquaint himself with the rates at which certain kinds of exchange of goods or services are from time to time made by the others".

Cournot defines market as ".....not any particular market place in which things are bought and sold, but the whole of any region in which buyers and sellers are in such free intercourse with each other that the prices of the same goods tend to equality easily and quickly"

According to Benham market is "any area over which buyers and sellers are in close touch with one another, either directly or though dealers, that the price obtainable in one part of the market affects the price paid in other parts".

Stonier and Hague explain the term market as "any organization whereby buyers and sellers of a goods are kept in close touch with each other…. There is no need for market to be in a single building…. The only essential for a market is that all buyers and sellers should be in constant touch with each other, either

because they are in the same building or because they are able to talk to each other by telephone at a moment's notice".

In case we study the above-mentioned definition of a market, we find that a market has four basic components:

(1) Consumers

There should be buyers of the product. For example in a country where the whole population is very poor, there can hardly be a market for luxuries like cars, VCRs, etc.

(2) Sellers

Unless a commodity is offered for sale in the market there is no question of anybody buying the commodity. Therefore, for any market, the existence of sellers is another necessity.

(3) A commodity

Each commodity has a separate market, in the sense that every community has a separate set of buyers and sellers. So, far a market we consider only buyers and sellers who come in close contact with each other for the same good.

(4) A price

The exchange of commodities between the buyers and sellers occurs at a particular price, which is mutually agreeable to both the buyers and sellers of the commodity.

Criteria for Market Classification

We can classify market into different types, Various bases of market classifications are the following:

(1) Classification by the 'area'

When area is used as a basis of market classification, we categorize markets into local markets, regional markets, national markets and international market. If buyers and sellers are located only in a particular locality, village or a city, we have a local market, like for perishable goods, e.g. vegetables and fruits bulky items, e.g. sands, bricks, etc. The local market is mainly dependent on local conditions. Similarly, for durable goods we will have regional and national markets, where the regional and national conditions influence the market. International Market consists of transactions between the national of different countries.

(2) Classification by the nature of 'transactions'

We can classify the markets on the basis of nature of transactions into two broad categories: the spot market and the futures market. Where goods are

physically exchanged on the spot, the markets are called spot markets. In case the transactions involve the agreements of future exchange of goods such markets are known as futures markets.

(3) Classification by the 'volume of business'

On the basis of the volume of business, the markets are broadly classified into wholesale markets goods are transacted in large quantities whereas in a retail market transactions involve small quantities. Wholesale markets are, in fact, a link between the producer and the retailer while the retailer is a link between the wholesaler and the consumer.

(4) Classification on the basis of 'time'

Sometimes the time element is used to classify the market. The time is classified as very short period, short period and long period. Very short period markets relate to transactions in those commodities, which are fixed in supply or are perishable in nature. Since supply is fixed, only the chances in demand influence the price in such markets. The short period markets are those where supply can be increased without any limitation. The influence of demand on price is therefore, greater in case of short period market than in case of long period markets. Both these markets exist in durable goods.

(5) Classification by the 'status of sellers'

During the process of marketing, a commodity passes through a chain of sellers and middlemen. Markets can also be classified on the basis of the status of these sellers. On the basis of the status of sellers the market are broadly classified into three categories: primary, secondary and terminal markets. The primary market consists of manufactures that produce and sell the product to the wholesalers. The wholesalers who are in intermediate link between the manufacturers and retailers constitute the secondary market, while the retailers who sell it to ultimate consumer constitute the terminal market.

(6) Classification by 'regulation'

On this basis the markets can be classified as regulated and unregulated. For some goods and services, the government stipulates certain conditions and regulations for their transactions. Market of such goods and services is called regulated market. On the other hand, goods and services, whose transactions are left to the market force, belong to unregulated market.

(7) Classification by the nature of 'competition'

The most important form of market classification is based on the nature of competition, i.e., the buyer - seller interaction. The competition in the market depends on three main factors:

(a) Substitutability factors:

(b) Inter-dependence factor; and

(c) Ease of entry factor.

Market Forms or Market Structure

However, Economics have classified market or situations under the following categories:

(i) Perfect competition

(ii) Monopoly and

(iii) Imperfect competition

(i) Perfect competition: This type of market situation arise when there are large number of buyers and sellers in the market dealing in homogeneous product with perfect liberty on the part of buyers and sellers to enter or leave the market as they choose. The price prevailing in such a market will be one price, and the price cannot be influenced by sellers or producers by their individual actions nor is it possible for them to combine. The market will have equilibrium price on the basis of aggregate demand and aggregate supply. The degree of control over price is nothing on the part of the seller.

(ii) Monopoly: It is a market situation in which the entire supply is controlled by one seller in the particular market area. The firm and the industry in this situation are identical. The product of the monopolist may not have close Substitute. New firms cannot compete with the existing monopolist. In such a situation, the price elasticity of demand will be very small and the monopolist will have considerable power to fix the price and amass large net monopoly revenue.

(iii) Imperfect Competition: In between these two extremes, viz., perfect competition and pure monopoly, there exists and imperfect condition in which we have the features of competition as well as features of monopoly. Such a condition is called imperfect competition. The credit of developing the theory of imperfect competition goes to Mrs. Joan Robinson. Imperfect competitions take different shades. They are (a) monopolistic competition; (b) Oligopoly with or without product differentiation.

(a) In the case of monopolistic competition, there will be a larger number of firms producing the commodity. But this number will not be so large as to constitute perfect competition. All these will be competing in the market. They will enjoy a certain degree of monopoly because of product differentiation. Though there is product differentiation, the products of different firms are substitutes, but may not be close substitutes.

(b) Oligopoly market is a situation in which there are few large sellers and the product will be more or less perfect substitutes. The produce may be

homogeneous as in the case of petrol, fertilizer, or it may be differentiated as in the case of ratio, typewriter or drugs.

Besides these, there are other forms of imperfections in the market situations. They are called:

(i) Duopoly;

(ii) Bilateral monopoly and

(iii) Monopoly.

In Duopoly there are only two sellers who control the entire supply. Hence the output and price policy of one is dependent on the other. Bilateral monopoly refers to a market situation where there is only one seller and only one buyer. This situation exists only in the nationalized industry which is the sole employer of a particular type of labour. For instance, the railways or ports are monopolies of government. Their trade unions have to negotiate with government and decide matters. Monopsony is a condition where there are many sellers, but only one buyer. It is the opposite of monopoly and it is a rare market situation.

The time element in the theory of Price:

Marshall was the first to bring out clearly the importance of time element in price determination. When the demand for a product rises or falls, it supply does not increase or decrease at the same time. Changes in supply depend upon technical factors, which take time to change. The time period involved in adjustment will depend upon the extent to which it is possible to make changes in the scale of production, size and organisation of the industry in accordance with the changed demand for its product.

Marshall divides time period into four categories : Market Period, Short period, Long Period and Secular Period.

Market Period (or, Very Short Period)

The market period is defined as a period where no adjustment in supply is possible. Thus, the price is determined only by changes in demand. In fact, one cannot specify beforehand any time period as a market period. The length of the market period differs from commodity to commodity.

Short Period

The short period is defined as the period in which the firm is free to vary its output but does not have the time to change it scale of plant. The number of firms in the industry would be fixed because new firms do not sufficient time to enter into the industry not the existing firms will have the time to leave the industry. Any changes in supply must come from a plant capacity of the existing firms.

In the short, the forces of demand and supply determine price.

Long Period

The long period is defined as a period long enough to enable the industry to adjust its supply and output completely to changes in its demand. New firms can enter the industry old firms can leave the industry and the capacity of the existing firms can be adjusted to any extent to match the market demand. In the long period, all factors of production are variable and there is nothing like fixed cost in this period. The minimum price of the product cannot be less than the average cost of production. thus, there will be no loss to the firm.

Secular trend

Marshall also talked of a secular period or very long period for the sake of completeness. The secular period will include all the changes in demand and supply which require a long period will include all the changes in demand and supply which require a long period of time, such as the changes in the size of population, supplies of raw materials, etc. They very long period is essentially a historical category and is not useful for business analysis.

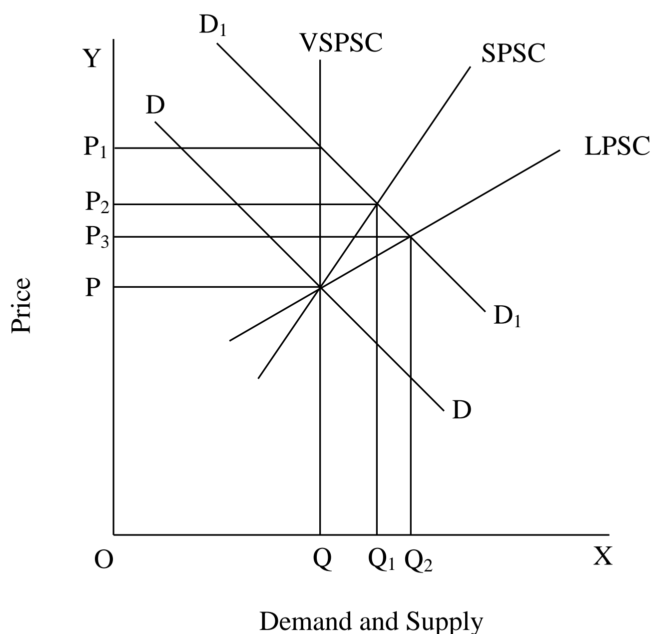


Fig 8.1

In very short period supply cannot be changed. Price is OP. A Change in demand from DD to D1D1 leads to change in price from OP to OP1. Short period quantity is increased from OQ to OQ1. Price has come down from OP 1 to OP2. Long period price has fallen from OP2 to OP3 because of quantity is expanded from OQ1 to OQ2.

In short, very short period, price is the only influencing factor but short and long periods both desmand and supply are, very influencing factors.

NOTES

LESSON - 9

PERFECT COMPETITION

Definition of Perfect Competition

'Perfect Competition' is defined in different ways and there is no agreed common definition. Prof. Frank Knight express the term 'Perfect competition' as a condition of market in which there will be fluidity and mobility of factors of production so that the number of firms and the size of firms can freely increases or decrease. According to him perfect competition entails "rational conduct on the part of buyers and sellers, full knowledge, absence of friction, perfect mobility and perfect divisibility of factors of production and completely static conditions". Thus knight consider the freedom of entry and exit of firms as the important criterion in perfect competitions.

Mrs. Joan Robinson defines perfect competition in terms of elasticity of demand. In perfect competition there will be perfect elasticity of demand for the product of every individual producer. For this, tow conditions are necessary. There should be large number of sellers, and the buyers should be aware of the various price offers and their perfect conditions so that they have no reason to prefer on seller to another. Sometimes a distinction is made between pure competition and perfect competition. The former means only absence of monopolistic elements, though it may not have full features of perfection. The term perfect competition can be better understood by explaining the features rather than defining the concept.

Features and Conditions of Perfect Competition

(1) Large number of buyers and sellers: In a perfectly competitive market there will be a large number of buyers and sellers. Many firms producing the commodity will offer their quantity in the market and sell it at market price.

The term large number of buyers and sellers has special significance in perfect competition. Large number denotes that the number of producers are so numerous that they cannot combine and influence the market price by their combined action and decisions.

(2) Homogeneous Product: The second condition in the perfect market is that the commodity offered should be homogeneous and identical in all respects. All firms in the market produce the same quality or variety of the commodity and practically there will be no difference in the product of the two firms.

(3) Free entry and exit conditions: The third important condition in perfect competition is that there are no artificial restrictions either preventing

the entry of new firms into the market or compelling the existing firms to continue. The firms have full liberty to choose either to continue or go out of the industry.

(4) Perfect knowledge on the part of buyers and sellers: The fourth condition of a perfectly competitive market is the existence of perfect knowledge on the part of buyers and sellers about market conditions. The buyers know in full about the commodity sold and the price prevailing in the market. The sellers know the potential sales at various price levels in the market.

(5) Perfect mobility of factors of production: The existence of perfect competition depends on perfect mobility of factors of production. The factors should be free to move from one use to another easily depending on the remuneration they get.

(6) Absence of transport cost: Ina perfectly competitive market, it is assumed that there are no transport costs. If transport cost is incurred, prices should be different in different sectors of the markets.

(7) Absence of Government or artificial restriction: Lastly it is assumed that there are no artificial restrictions from any quarter hindering the smooth functioning of perfect competition. There is no government control or restriction on supply, pricing, etc, and the price should be free to change in response to changes in demand supply conditions.

Equilibrium and Price Output Determination of a Firm under Perfect Competition.

Condition for Equilibrium of the Firm

The first achieves equilibrium position when the MR equals MC. MC curve is the supply curve of the individual firm, because it indicates the cost of producing additional units. Any rational firm may go on supplying up till that particular point, when MR equals MC. If AR > AC, the firm may benefit by increased profits obtained as a result of producing additional units. On the other hand, when AC > AR, the last few additional units that the firm had produced, has resulted in a loss. AR = AC gives only normal profit.

Price Determination in the Industry Market Demand and Market Supply

Short run is that particular time period, where the supply does not have enough time to get adjusted to the demand. In the short period, firms may make super normal profits, normal profits or losses, depending upon their level of cost.

By market demand we mean the aggregate demand (demand of all consumer in the market) for the product at different prices. The market demand

curve is downward sloping indicating that more quantity is demanded at lower prices and less quantity is demanded at higher prices.

Market supply refers to the aggregate supply coming from all the sellers and it depends on the ability and willingness of each individual firm to supply a certain quantity of a product in the market at a given price. The market supply depends on the cost conditions of the respective firms.

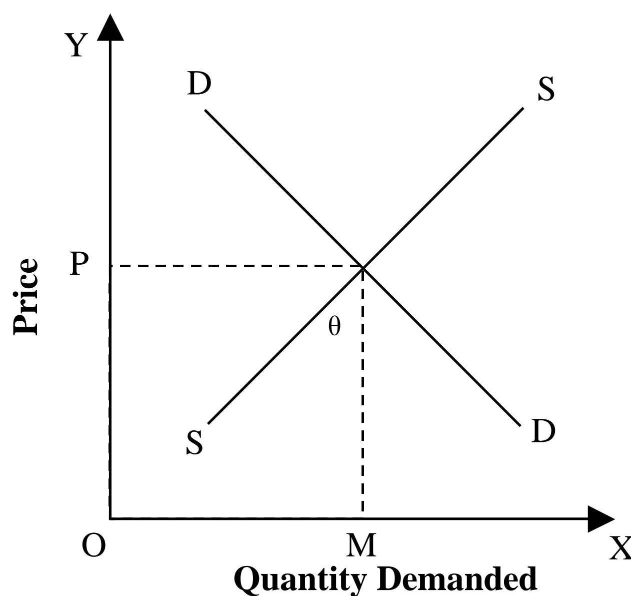


Figure 9.1

Market price is determined as a result of the operation of two forces, i.e. market demand and market supply. Market price is that point (as depicted in Figure) at which the market demand curve intersects the market supply curve. This price determined in the market, is accepted by all firms in the industry (under Perfect Competition) as given.

Thus, the price is given to firms. In the short run, firms may make supernormal profits, normal profits or losses depending upon the cost conditions of the individual firms. Given below are instances of firms making super normal profits, normal profits and losses.

Price output Equilibrium of a Firm under Perfect Competition in the Short Run Example of a Firm A, which makes super normal profit

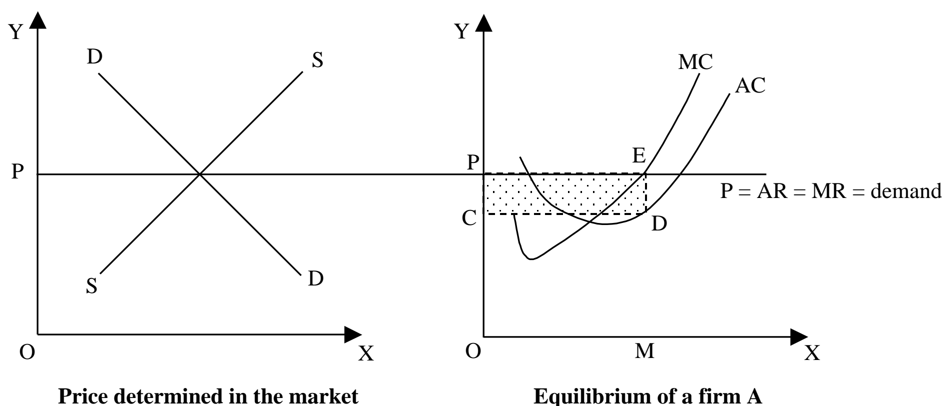
All firms accept the equilibrium price determined in the market and so does firm A. As depicted in figure the demand curve, Average revenue curve and the Marginal curve coincide. The AR curve of the demand curve indicates the quantity demanded at different prices. Under Perfect competition, consumers are willing to buy any quantity of goods for a given price 'P'. Therefore, the AR curve or the demand curve is perfectly elastic, horizontal and

parallel to the X-axis. The MR curve also coincides with the AR curve because all additional units sold are sold at the same price.

The firm A reaches its equilibrium, at that particular point, where MR equals MC. When this point is extended to the X-axis, equilibrium output level can be found. The same equilibrium point, when extended to the AC curve, the average cost for that particular output can be determined and when extended to the AR curve the average revenue or the price can be determined.

In the case of Firm A, the price OP is given to the firm. Equilibrium is achieved at the point where MR equals MC (E). The equilibrium output is OM. The product of these two give the Total Revenue, as depicted by the bigger rectangle (OPEM) in the graph.

Graph depicting equilibrium output of a Firm A making supernormal profits.



Price determined in the market **Equilibrium of a firm A**

The Total cost of the firm is the product of average cost and the Total output depicted by the smaller rectangle, OCDM. The excess of Total Revenue over that of the Total cost is that profit and that is depicted by the shaded region CPED. Firm A makes supernormal profits.

In the short run, when most of the firms make super normal profits, new firms are attracted into the industry. Then market supply thus increases, bringing down the price. The extra supernormal profits are thus competed away, with the entry of new firms.

Instance of a firm (Firm B) which makes normal profits:

Firm B also accepts the market price OP. The AR, MR, demand and price curve coincide and are horizontal and parallel to the X-axis. AC is the average cost of the firm and MC is the marginal cost curve of the firm. Equilibrium is achieved at that point where Marginal Revenue equals Marginal cost, which is E.

The rectangles depicting the Total cost (OPEM) and Total Revenue (OPEM) also coincide. Therefore firm B makes only normal profits. The price itself includes a certain markup for normal profits.

Instance of a firm (Firm C) which makes losses

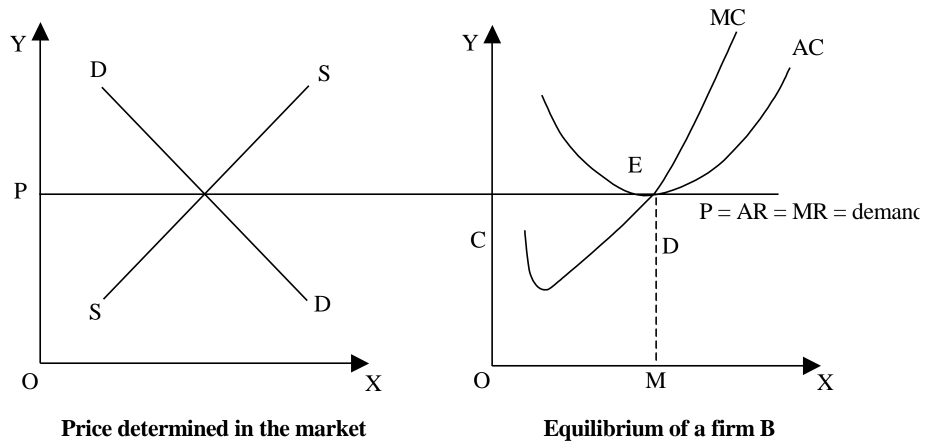


Fig. 9.3

Firm C, whose costs are high, as indicated by the AC curve AC, which is higher than that of revenue curves, makes losses. It accepts the price OP as given by the market. It reaches the equilibrium at point E, where Marginal Revenue (MR) equals Marginal Cost (MC). This point when extended to the X-axis gives the output level OM. The corresponding Average cost at outputs level OM is OC. The Total Revenue as depicted by the graph is OPEM (the smaller rectangle). The Total cost is depicted by the bigger rectangle, OCFM. As TC > TR, the firm makes losses.

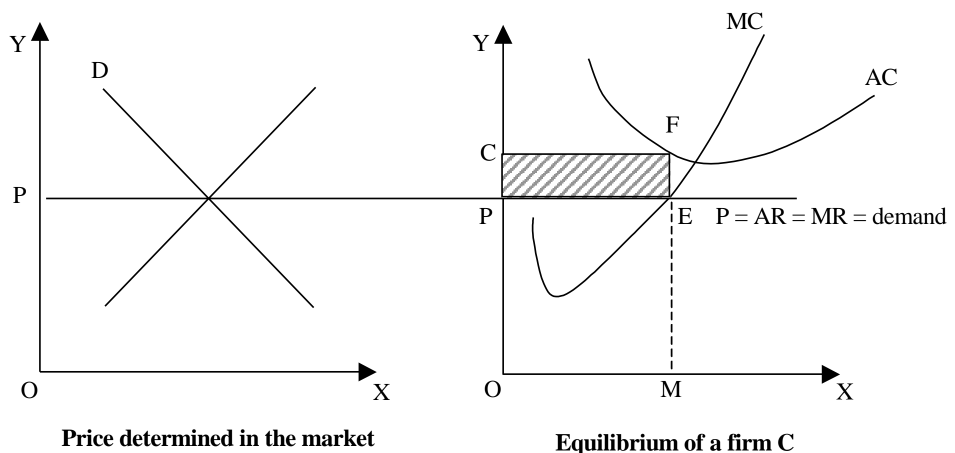


Fig. 9.4

In the short run, when most firms in the industry make losses, loss-making firms leave the industry, as there are no barriers to exit. When firms leave the industry, the market supply comes down, thus pushing up the price and increasing the profit level to normal profits.

Price Output Equilibrium of Firms in Perfect Competition in the Long Run

In the short run, most firms under Perfect competition may either be making super normal profits, normal profits or losses. When most firms make super normal profits, new firms enter the industry, thus bringing down the price and therefore the extra profits are competed away. When most firms make losses in the short run, a few firms making losses will exit, bringing down the supply, which leads to an increase in the price. The increase in the price, help most firms to wipe away their losses and reach a situation, where they make normal profits. It is thus clear that in the long run firms are in equilibrium, only when they make normal profits.

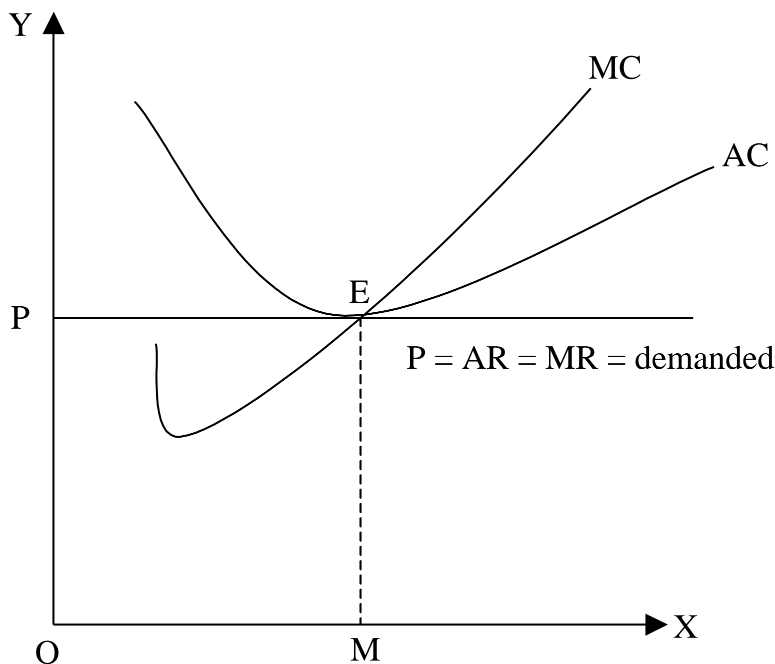


Figure 9.5

NOTES

LESSON - 10
MONOPOLY

The word monopoly is derived from two Greek words-mono and ploy. The meaning of mono is single and poly means selling. Monopoly therefore prevails in the market when there is a single seller. In Economics the monopolist is defined as the sole producer of a product which has no close substitutes.

According to Stigler a monopoly is firm producing a commodity for which there are no close substitutes.

In the words of Donald Watson, "In the standard definition, a monopolist is the only producer of product that has no close substitutes".

According to Benham, the monopolist, controls the supply of some commodity for which there is no very close substitutes.

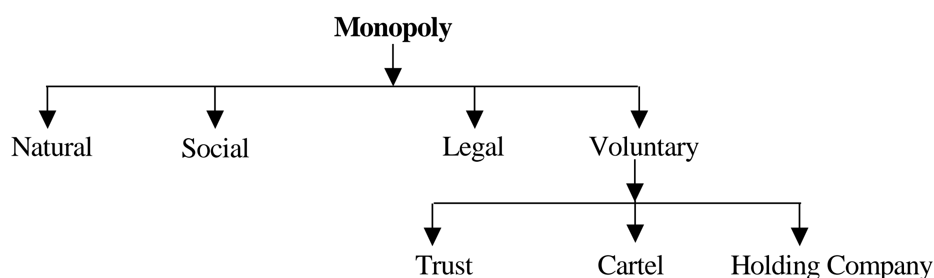
According to Stonier and Hague, "The monopolist is the sole producer of a product which has no closely competing substitutes"

Features of Monopoly

It is the situation of single control over the market. Commodity produced by the monopolist has no close substitutes. There is no possibility for any one single producer or joint stock organization or any organization or Government.

Types of Monopoly

Monopolies are of several types, Generally they are classified in the following manner:



Natural Monopoly

When monopoly arises due natural factors like climate, we call it as natural monopoly. For example, gold mining in South Africa, Tea in India, Petrol in Arabia, Tobacco in Greece etc.

Social Monopoly

These monopolies are created to satisfy some social wants. For example, all public utility concerns - Posts and Telegraphs. Railways, Electricity etc.

Legal Monopoly

Some monopolies are legally granted and they are called legal monopoly. For example special brands, trade names, patents and copyrights are the examples of legal monopoly.

Voluntary Monopoly

A voluntary monopoly is created when the firms producing the same product join together voluntarily to control the supply of the commodity with a view to earn more profits. The objective here is to avoid unnecessary competition. For example, All India Sugar Syndicate. This monopoly is classified into three classes, Viz. Trust, Cartel and Holding Company.

Trust is a monopolistic combination of many firms. The best example of a trust in India is A.C.C. in Indian Cement Company.

Cartel is also a monopolistic combination of the firms. The Indian Sugar Syndicate is the best example of Cartel in India.

Holding Company is a modern method of bringing a number of firms under one control. It is primarily a financial institution. The Holding Company has become an important organization for large concerns in both Great Britain and the United States.

Price - Output Equilibrium under Monopoly

Short Period

a) Abnormal Profit:

Considering that the monopolist faces an inelastic demand curve, the monopolist will prefer to keep the prices high and the volume of production low. A monopolist may, both in the short run and long run make either profits or losses. In other words as in the case of Perfect Competition, the long run situation may not be very different here. It will only be similar to the short run, because there are strong barriers to entry and exit.

In the graph the monopolist reaches the equilibrium at that particular point, where MR = MC. This when extended to the X-axis, we get the equilibrium output and when extended to the AC curve and the AR curve respectively, we get the equilibrium price and the average cost for the equilibrium level of output. In the graph ORPRM is the Total Revenue. The Total cost is OCSM. The shaded portion CPRS indicates the abnormal profit.

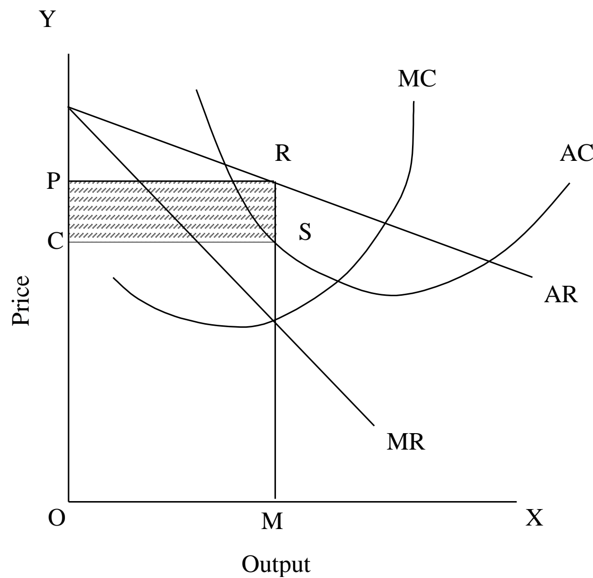


Figure 10.1

b) Loss:

A monopolist may also make losses. This situation is also depicted in the graph. The cost curves lie high, well above the average revenue curve. Due to the highly inelastic nature of the demand curve, the firm reaches the equilibrium output level, even before the average cost reaches the minimum point. In other words, the firm achieves the equilibrium level of output, much before it reaches the economically efficient level of production (that level of production, when AC is minimum). Because the cost curves lie above the average revenue curve, the firm makes losses. In the graph OCSM is the Total Revenue. The total cost is OPRM. The shaded portion CPRS indicates loss.

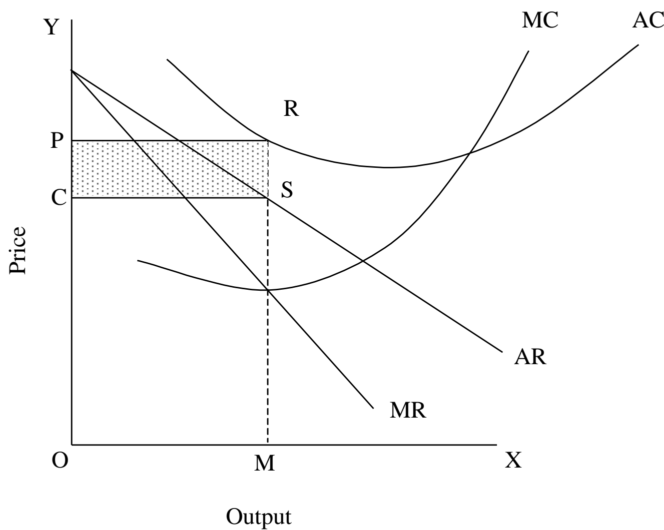


Figure 10.2

In the graph OCSM is the Total Revenue the Total Cost is OPRM. The shaded portion CPRS indicates Loss.

Long Period :

Long period earns abnormal profit

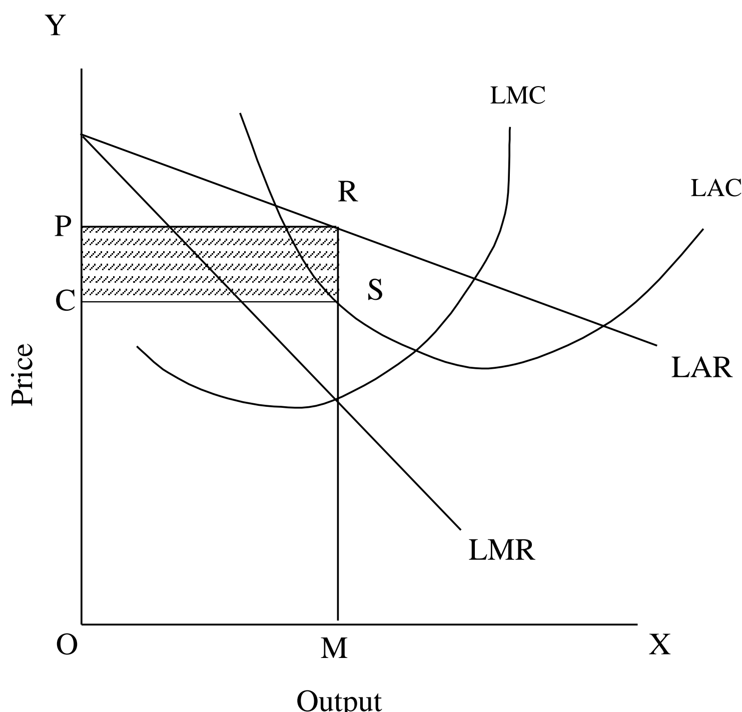


Fig 10.3

In the graph the monopolist reaches the equilibrium at that particular point, where MR = MC. This when extended to the X-axis, we get the equilibrium output and when extended to the AC curve and the AR curve respectively, we get the equilibrium price and the average cost for the equilibrium level of output. In the graph OPRM is the Total Revenue. The Total cost is OCSM. The monopolist is a single seller or producer. So definitely gets abnormal profits. The shaded portion indicates abnormal profit.

Equilibrium of a Monopolist in the Short and Long Run

Under monopoly, the distinction between firm and industry disappears. Thus, the firm's equilibrium is also the industry's equilibrium. Since there is no competition, the long run situation may not be very different than that of the short run. In perfect competition, we observed a situation where new firms enter or exit, depending upon whether a majority of the firms under perfect competition may profits or losses. Since, strong barriers to entry and exit, exist in the case of monopoly, entry of new firms or exit of the loss-making monopolist is prevented. Thus, there may be very little difference between the long run and the short run. In the long run also, firms may continue to make

super normal profits or may make losses. Therefore, the long run equilibrium will be similar to that of the short run equilibrium situation. The only difference being that in the long run the firm may be facing a demand curve, which is slightly more elastic.

The Consequences of Monopoly

Monopoly has been criticized and considered as against public interest from the days of Adam Smith. It is assumed that the powerful monopolist exploits the consumers whereas competition helps the consumers. Traditional economic theory has advocated competition as the best market situation compared to monopoly. In this section, we shall discuss the case for and against monopoly.

The Case for Monopoly

The last Sir Henry Clay has pointed out certain merits of monopoly in his article - The campaign against Monopoly and Restorative Practices' published in Lloyds Bank Review of 1952. He has pointed out some instances where in monopoly may be in the public interest.

1. Monopolies May produce more efficiency

Monopolies because of their large organization can produce more efficiently and at a lower cost compared to competitive firms. This organization can get the technical and commercial advantage over the smaller firms of competition. Sir Henry Clay gives the example of the British Cement Industry, which is the monopoly firm and points out that its prices are lowest in the world. The British Electric Lamp Company is another example of monopoly organization producing more efficiently. This industry is working at lower costs of production.

2. Monopoly can withstand depression

Monopoly because of its larger financial resources and strength can withstand the depression. This is not possible for the small competitive firms. If the depression is severe, they have to close down their business, for example, the British Cotton Industry survived the depression of 1929 - 32. The other monopoly concerns like steel, coal and shipbuilding could also withstand the depression because of their monopoly actions.

3. Cut-throat competition may ruin the business

Clay has pointed out that under competition the price may be driven down to such a lower level which may not even cover the cost of production. Therefore, each firm tries to get larger share in the market. This may result in cut-throat competition and such competition may ruin the business. Such a situation does not arise under monopoly as there is absence of competition.

4. Reduce inequality of income

Generally, it said that monopoly increases the inequality of income. The monopolist gets profit by exploiting the consumer. But there are certain circumstances in which monopoly reduces inequality of income. For example, the monopoly of laborers i.e. trade unions fighting for higher wages reduce the inequality of income and wealth.

The case against Monopoly

1. Lesser output

Monopoly results in lesser output and higher price compared to perfect competition.

2. Monopoly prevents the best use of resources

A monopoly firm produces at the point where marginal cost curve is equal to marginal revenue and not the average cost is at a minimum as under perfect competition, Monopoly prohibits the best use of resources.

3. Consumers are at a loss

Under conditions of perfect competition the consumer buys the last unit for a price equal to the marginal cost of it. The consumer stands to gain under perfect competition. Under conditions of monopoly the price is greater than the marginal cost of production. Therefore, the consumer is the sufferer under monopoly.

Controls of Monopoly

The monopolist cannot exercise an absolute control over prices and output. He cannot behave like an autocrat and at the most he can have control over prices and output. The monopoly power is limited by the following factors:

1. Potential Competition

A monopolist is always worried about the potential rivals. When the monopolist changes a very high price and earns enormous profits, dynamic entrepreneurs will enter into the production of similar commodities and share the enormous gains which he is making. This possibility of competition limits the use of monopoly power.

2. Substitutes

This acts a threat to monopoly power. The substitute may not be always satisfactory. If the monopolist charges a very high price, the consumers use the substitutes and this may put a limit to the monopoly power. For example if the State Electricity Board charges a very high price for the domestic consumers, they may check this by using gas or kerosene.

3. Consumer's Association

The abuses of monopoly can be controlled by forming the association of consumers. The consumers may resist the high price charged by the monopolist by boycotting the purchase of the commodity. The bargaining power of the consumers increases when they have a better organization. This is also considered as one of the powerful means of controlling the monopoly.

4. Anti-Monopoly Legislation

The monopolies may be controlled by anti-monopoly legislation. The legislation may aim at

1. Preventing monopoly firms from coming into existence.
2. When they come into existence; get them dissolved and split them into a number of competing firms: and
3. Prevent the unfair practices of the monopolist.

5. Publicity

Pigou has suggested an interesting method to control monopoly. He contends that the monopoly firm will be afraid of the public if all their details are published very often. The details regarding the use of unfair practices, donations to political parties, their huge profits and bribing of legislators. When such details are given a wide publicity, the monopolist may follow more reasonable method.

6. Nationalization

This solution is popular in counties like India. This may solve some of the problems of monopoly. Therefore, it is suggested in many countries to control monopolist.

NOTES

LESSON - 11
MONOPOLISTIC COMPETITION

Meaning

Monopolistic compression is a combination of both 'monopoly' and 'competition' The credit of developing this theory goes to Prof. Edward Hastings Chamberlain of Harward University. He is the main architect and builder of this theory. In reality there is no monopoly and perfect competition and there exists only monopolistic competition.

Main Features

Monopolistic competition is characterized by the existence of several firms selling goods which are close substitutes of each other. The following are the important features of monopolistic competition.

1. Existence of a large number of firms

There are a large number of firms producing goods under monopolistic competition. It may vary from ten to thirty, as the number of firms is quite large.

2. Product Differentiation

The most important feature of monopolistic competition is product differentiation. The products are identical but not similar. For example, different manufactures produce soaps under different brands like Lux, Hamam, Pears, Lyril and so on. Product differentiation can be brought about through differences in branding, trade mark, package, design and colour.

3. Selling Costs

Another feature of monopolistic competition is selling costs. The firm under monopolistic competition should incur certain expenditure on promoting the sales. The amount spent by the firm on sales promotion is known as selling costs. Selling costs include not only the advertising costs but also other costs such as salaries of salesman, door to door canvassing etc.

4. Free entry and exist

There is a freedom of entry and exist of firms. A new firm may enter into the production and an old firm may come out of the production.

5. Group of firms

In monopolistic competition, the term "Group Equilibrium" is used to denote the number of firms producing similar goods

Price Determination under Monopolistic Competition:

Short-run Equilibrium

Under monopolistic competition, different firms produce different varieties of products. Each firm will fix its own output and price. Like any other firm, the firms under monopolistic competition attempts to maximize the profits. The firm under monopolistic competition in the short-run will be in equilibrium when MC = MR. The price and output determination are shown with the help of the following diagram.

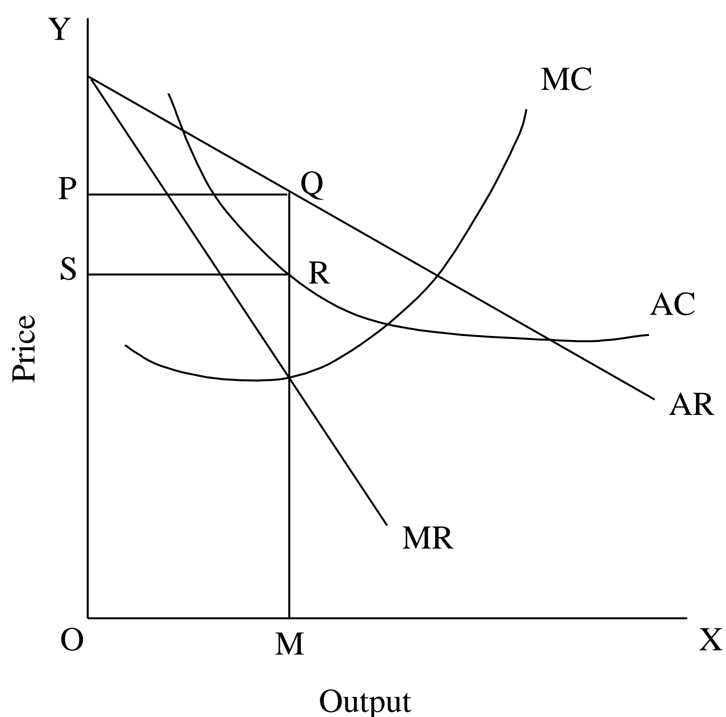


Fig. 11.1

In the diagram-

AC is the average cost curve.

MC is the marginal cost curve.

AR is the average revenue curve.

MR is the marginal revenue curve.

At point K equilibrium is established, where MC - MR. The equilibrium output is OM. MR is the cost and MQ is the price, the firm earns super normal profits which are shown by the shaded area PQRS.

Equilibrium with Losses

When average revenue is less than the average cost the firm may incur loss. This is shown in the following diagram

Q is the equilibrium with MR - MC.

PQRS-Total Loss.

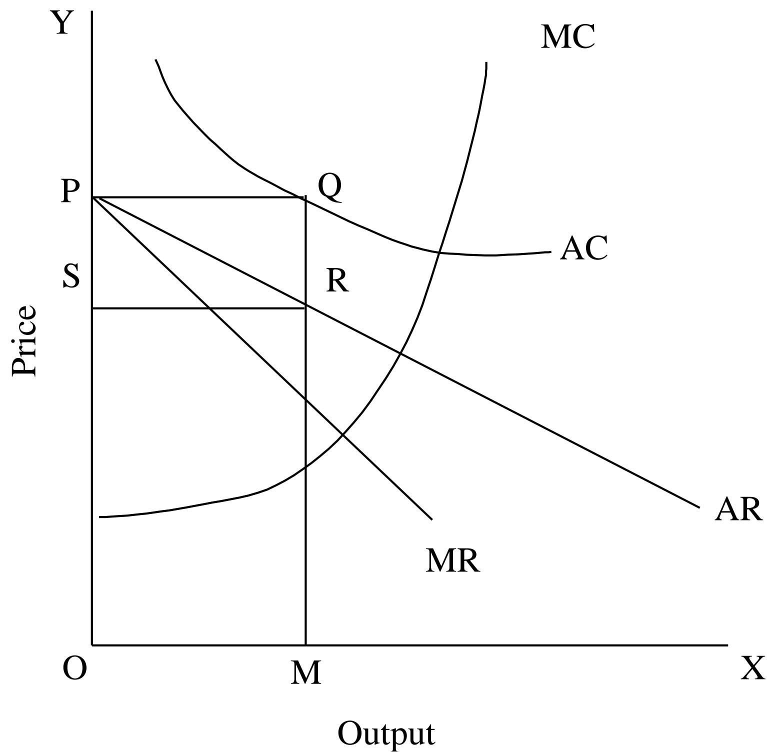


Fig 11.2

Long-run Equilibrium or Group Equilibrium under Monopolistic Competition

According to Prof. Chamberlin, a group consists of many firms whose products are very much similar to one another. A 'Group' is not one industry. The term 'industry' is much broader than the term 'group'. An industry may consist of many groups of Producers. For example, in the soap industry, one group may specialize in toilet soap another group may produce shaving soap. There will be a competition between the firms in the same group but not between different groups.

In order to present the group equilibrium, Prof. Chamberlin makes certain assumptions. The important assumption is that each firm has identical demand. This assumption is called the "Symmetry" or "Heroic" assumption. The equilibrium of group under monopolistic competition may be shown with the help of the following diagram.

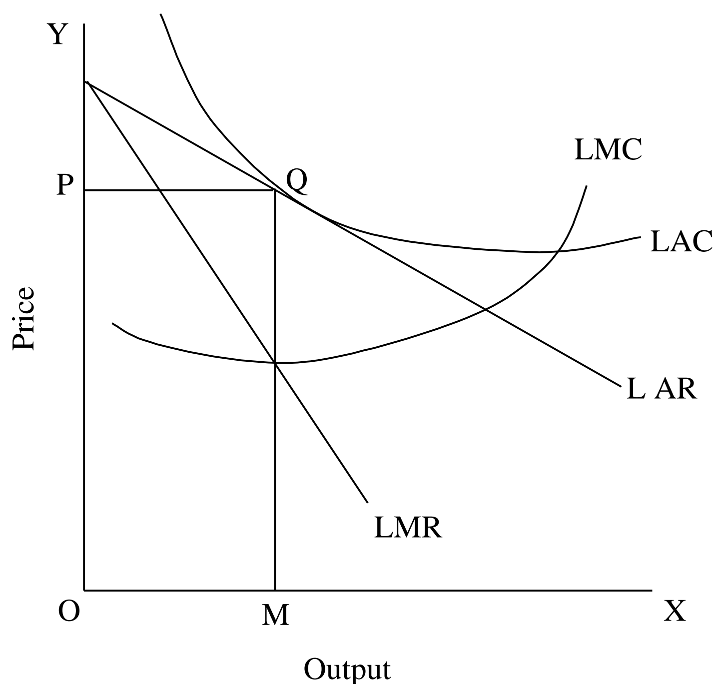


Fig. 11.3

The long-run group equilibrium is established at the point where AC-Price. This is possible only when the AC is tangent to the AR. In this figure AR is tangent to AC curve at point Q. The equilibrium output is OM and the price is OP which is equal to the cost of production. At this price, the firms in the group are earning only normal profits and supernormal profits have disappeared. All the firm in the group are also in equilibrium. This is called 'Group Equilibrium'.

Selling Costs

The firm under monopolistic competition incurs certain expenditure on selling activities. This is called selling cost. These objective of the selling costs is to increase the demand for the products of he firm. Prof. Chamberlin has defined selling costs as costs incurred in order to alter the position and shape of a demand curve for a product.

NOTES

LESSON - 12

PRICE DISCRIMINATION

Introduction

A special feature of monopoly is price discrimination, i.e. charging different prices from different customers, or from different customer groups, for the same commodity. Price discrimination is of the first type, when different prices are charged for different buyers. Professionals like doctors, lawyers may collect higher fees from rich persons and lower rates from poorer persons.

Joan Robinson defines price discrimination, as the act of selling the same article produced under a single control at different prices to different buyers is known as price discrimination.

Price discrimination of the second order is that where may be discrimination in prices between different geographical areas; say local market and international market. Thus, the monopolist may charge higher price from domestic consumers and lower price from international consumers. He may charge one price in villages and another one in cities.

Price discrimination of the third order is that where, a monopolist may charge different prices for different customer categories. Thus, in Railways, First class passengers pay a disproportionately high charge; on the other hand second-class passengers pay concessional rates.

Thus, based on the principle of ability to pay (rich and poor consumer), a monopolist may practice discrimination. Price discrimination may also be practiced to take advantage of the distance barriers between national and international market or rural and urban market etc. When a monopolist faces demand curves of different elasticities in different markets, he may charge different prices to maximize his returns in each of the markets.

The following could be the reasons for price discrimination.

a) Customer's ignorance b) Distance c) Customer preferences or prejudices d) Personal services, as in the case of doctor and other professionals, where it is possible to differentiate between customers.

Conditions necessary for price discrimination

1. There must be imperfection in the market.
2. There must be two different markets for the product. The market for the segmented class of consumers must be separable by distance or some other factor so that the buyers are not in a position to resell the commodity in the other.
3. The elasticity of demand for the product must be different in different markets.

Objective of Price Discrimination

What are the reasons for price discrimination? Is it a desirable phenomenon? The following reasons could be thought of for price discrimination.

Profit Maximisation : if a monopolist could maximize his profit by a policy of price discrimination then he will definitely practice price discrimination.

Greater Sales : Under discriminating monopoly a greater volume of output could be sold than under pure monopoly.

Principle of Equity : In conforms to the principle of equity. Price is charged according to the paying capacity of people.

Dumping : Dumping as a tool of discrimination monopoly achieves many objectives. It helps to dispose the surplus stock of a commodity. If an industry faces increasing returns, it could be taken advantages of by increasing the level of production. It helps to capture foreign market.

Welfare : It helps the weaker sections of society especially subsidization of food grains and low rent houses for them etc. It thus helps to reduce inequalities of income.

Is price discriminations useful for the community? In a way we can say that it is good for the society. Since doctors follows price discrimination many poor are able to get the service and in the same way dual food grains price help the poor.

Secondary it enhances the level of output and thus increases employment opportunities and raises national income.

But there are also some arguments against price discrimination. Since under first degree discrimination the monopolists take away they entire consumer surplus it is not desirable. It is also said that discriminating monopoly creates distortions in the economy. It leads to mal distribution of resources. It is not desirable to take away resources from the industry, which does not practice discrimination and put them into the industry, which practices discrimination. Moreover price discrimination in the form of dumpling is undesirable for it throws the economies of other countries out of gear. All said done price discrimination is desirable if it functions within the legal framework.

NOTES

LESSON - 13
OLIGOPOLY AND DUOPOLY

Oligopoly

Oligopoly is a term derived from two Greek words 'oligos' meaning a few, and 'pollein' meaning to sell. Thus Oligopoly refers to that form of imperfect competition where there will be only a few sellers producing either a homogeneous product or products which are close substitutes but not perfect substitutes. Oligopoly is also referred to as "Competition among the Few" as a few big firms will be producing and competing in the market. The simplest case of oligopoly is duopoly which prevails when there are only two producers or sellers in the market.

Prof. Stigler defines oligopoly as that "Situation in which a firm bases its market policy in part on the excepted behaviour of a few close rivals". According to Prof. Leftwhich "An oligopolistic industry is one in which the number of sellers is small enough for the activities of Single seller to affect other firms and for the activities of other firms to affect him". The best examples of oligopoly are markets for tea and petroleum where a big firm will be competing in the market of a country.

Classification of Oligopoly

There are different types of oligopoly depending on the relationship of the few firms producing the commodity.

(i) Pure or Perfect Oligopoly and Differentiated or Imperfect Oligopoly: Oligopoly is said to be pure or perfect based on the product. If firms competing produce homogeneous product it is perfect oligopoly. If there is product differentiation where the products of the few competing firms are only close substitutes but not perfect substitutes it is called imperfect or differentiated oligopoly. Production of cement, aluminium industry can be taken as the example of the former type while production of talcum powder or aspirin tablets may be taken as the example of the latter.

(ii) Open and Closed Oligopoly: In the former, the new firms can enter the market and compete with the existing firms. But in closed oligopoly, entry into the industry is not possible.

(iii) Collusive and Competitive Oligopoly: When the few firms of the oligopolistic market come to a common understanding or act in collusion with each other in fixing price and output it is collusive oligopoly. A non-collusive oligopoly denotes lack of understanding between the firms and they may be competing making the market competitive oligopoly.

(iv) Partial and Full Oligopoly: Oligopoly is partial when the industry is dominated by one large firm which is considered or looked upon as the leader of the group. The dominating firm will be the Price leader. The rest of the smaller firms would follow the leader in fixing prices of their products. In full oligopoly, the market will be conspicuous by the absence of price leadership.

(v) Syndicated and Organized Oligopoly: The extent and degree of co-ordination between the firms will decide this type of classification. Syndicated oligopoly refers to that situation where the firms sell their product through a centralized syndicate. Organized oligopoly refers to the situation where the firms organize themselves into a central association for fixing prices, output, quotas, etc.

On the basis of these different situations of oligopoly market, a few characteristic features of oligopoly can be enumerated. These special features are not found in other market forms.

Characteristics of Oligopoly

(1) Interdependence: The most striking feature of an oligopoly market is the independence of the firms operating. The price and output decisions of one will affect the other firms and any decision can be arrived at only after deep consideration of the possible reaction of the rival firms or firms in the group.

(2) Indeterminate Demand Curve: No firm in oligopoly can forecast with a degree of certainty about the nature and position of its demand curve whenever a change in price-output policy is contemplated. The firm cannot make an estimate of sales of its product if it were to cut the price by a certain percentage. Hence the demand curve or the revenue curve of the firm is indeterminate.

(3) Importance of Selling Cost: Indeterminate demand leads to be condition of aggressive advertisement to bring more customers into the fold of the firm. A direct effect of interdependence and indeterminateness of demand of various firms in oligopoly is the enormous selling cost incurred by the competing firms.

(4) Group Behaviour: Another peculiarity in oligopoly is the conflicting attitudes of the firms in the group. The firms know their interdependence in the market and they also realize the importance of mutual co-operation to their best advantage. When such desire to further their common interest arises, the group will have a tendency of collusion.

(5) Element of Monopoly: In oligopolistic market, where there are only a few firms, monopoly element may be present if there is product differentiation. Each firm controls a large share of the market and markets a differentiated product.

(6) Price Rigidity: Another important feature of oligopoly with product differentiation is prices rigidity. The price will be kept unchanged due to fear of retaliation and prices tend to be sticky and inflexible.

Pricing Under Oligopoly

Kinked Demand Curve - Sweezy's Model

Price rigidity under oligopoly is better explained by Kinked Demand curve used by Prof. Paul M. Sweezy. The Kinked Demand model represents a condition in which the firm has no incentive either to increase the price or to decrease the price but keep the price rigid at a particular level. The firm believes that the rival firms will not follow suit if it raises the price. But if it cuts down the price, the rival firms will follow suit. Acting on this belief the firm maintains the present price. If it increases the price, sales will be decreased automatically and the position will prove advantageous to the rivals who have not increase the price. If price reduction is resorted to the rivals also would do likewise and ultimately the sales might not improve appreciably. Hence to stick on to the present price is very expedient. Only in the event of any drastic changes in demand and cost conditions the firm could think of changing the price.

Under such a condition the demand curve of the firm, as anticipated by the firm would be kinked. This means that the curve will have a kink at the present price. The figure shows kinked demand curve according to Sweezy's model.

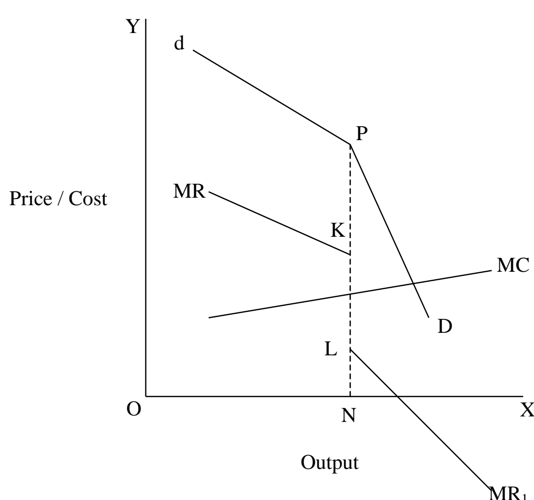


Figure 13.1

In the figure, the demand curve with a kink at point P has been shown. P is the price at which the firm is selling the product by producing ON units. Above the price P the demand curve as anticipated by the firm is DP. The curve is elastic. Below the price P the anticipated demand will be PB which is inelastic. This shows that when the firm increases the price above P and if all other firms maintain at the old price, then the demand for the firm's product would fall off. So, the demand curve is highly elastic above P (DP portion). The total revenue and profit of the firm would be reduced. The corresponding portion of marginal revenue curve is also shown in the figure (MR). If the firm decreases the price, the demand curve becomes much less elastic and the demand curve is shown as PB. Why is PB curve inelastic? As already stated the reduction in price will be followed by other firms and the sales may not increase appreciably than what it is at the price P. At this level, the marginal revenue is shown as MR1. When the demand curve is DP the Marginal revenue curve is positive. When the demand curve is PB the Marginal curve becomes negative. When there is no scope of better profit in either way why should the firm think of changing the price from what it is (P)? So the price PN as shown in the figure becomes rigid.

The peculiarity of this figure is that there is a gap or discontinuity in MR curve below the point of kink. KL shows the gap or extent of discontinuity between MR and MR1. This gap will depend on the elasticity of demand above and below the kink. The gap will be larger if the elasticity is greater above the kink and inelasticity is also greater below the kink. Price will not change in oligopoly unless there is a drastic change in demand and cost conditions.

The kinked demand curve theory of oligopoly explains the price rigidity but it does not explain how the price under oligopoly is determined. This method is not useful in case of price leadership or collusive oligopoly.

We will take up the two cases, viz., the equilibrium of a single firm producing under oligopoly without product differentiation and with product differentiation.

Equilibrium Without Product Differentiation

As a result of competition and price war let us imagine that the firms have settled down to a price OP. At this point the firm sells an output OM earning just normal profit. This OM output is the optimum output as it is produced at the lowest average cost. If the firm increases the price beyond OP it will lose all its customers because the product is not differentiated. It is assumed that other firms will not increase the price. The firm cannot reduce the price as it will go out of business without normal profits. The figure 13.2 shows this.

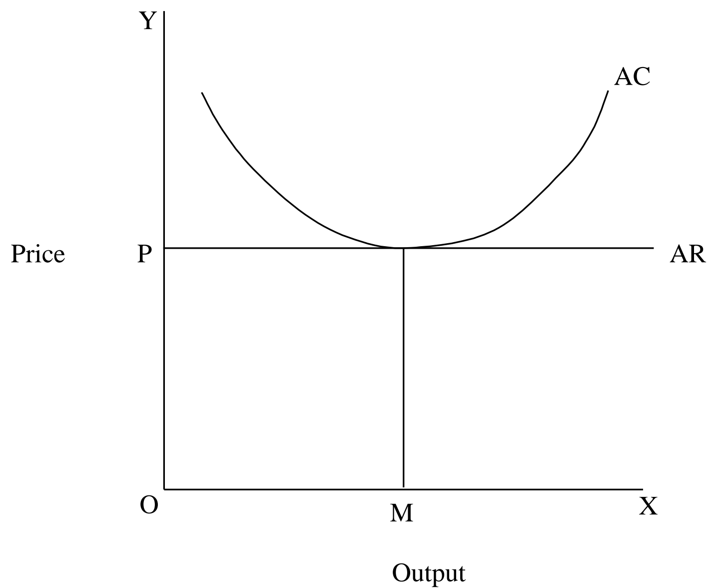
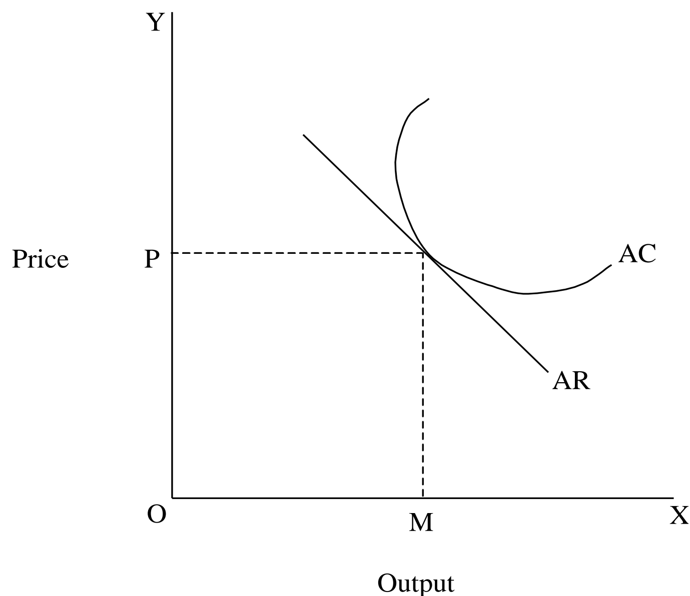


Figure 13.2

Equilibrium With Product Differentiation

Let us imagine that after price-war the price has settled at OP and the firm is producing ON output. The firm is earning just the normal profit. The equilibrium in the case of product differentiation under oligopoly is similar to monopolistic competition. The firm is earning normal profit but it is producing less than the optimum output.

Final price under oligopoly with product differentiation will lie between monopoly price and competitive price and it will vary from case to case depending on market conditions.



This figure 13.3 reveals equilibrium with product differentiation.

DUOPOLY

Meaning & Definition of Duopoly

DUO means two and poly means selling. Duopoly refers to a market situation in which there are only two sellers. Each seller tries to guess to rival's motives and actions. The two firms may either resort to competition or collusion. The object behind the former being to eliminate the rival and become a monopolist. On the other, realizing the difficulties and disadvantages of cut-throat competition, the two firms may agree to co-operate and fix the price. The competition will be in advertisement only.

Under duopoly, there is no product differentiation and goods are identical. The consumers are indifferent between the two producers and same price must be charged by both in the long run, otherwise a seller charging a higher price may not be able to sell more. They must fix the price as if they were a single monopolist. Only by this method they can maximize their profits. In case there is price-war between them, they will be able to earn only normal profit as in the case of perfect competition. If the price is different, the firm selling at a lower rate will dominate the market and ultimately establish as a monopolist. The best course for the duopolist is to monopoly price and share the market and profits.

Writers consider Duopoly as only a form of oligopoly or simple oligopoly. Duopoly models and explanations can also be taken as oligopoly models. Both types of markets are considered together, as duopoly is only a limited oligopoly.

A model of oligopoly, projecting duopoly was first put forth by Cournot, a French Economist. English Economist Edgeworth later on produced his model. These two models serve as classical solution to the problem of duopoly pricing. In modern days, Chamberlin, Baumol and Sweezy have contributed to duopoly and oligopoly pricing.

Coutnot's Model

Augustin Cournot has taken the example of a mineral spring situated side by side and owned by two persons who market their commodity. This is a condition of duopoly without product differentiation. There is no question of cost of production as they get the "Commodity" without cost of production. The average cost and marginal cost become zero. In this case of Duopoly, it is further assumed that the two sellers never change the output, i.e., output of the rival is fixed. The market demand for he product is assumed to be linear, i.e., a straight line. With these assumptions Cournot gives the solution.

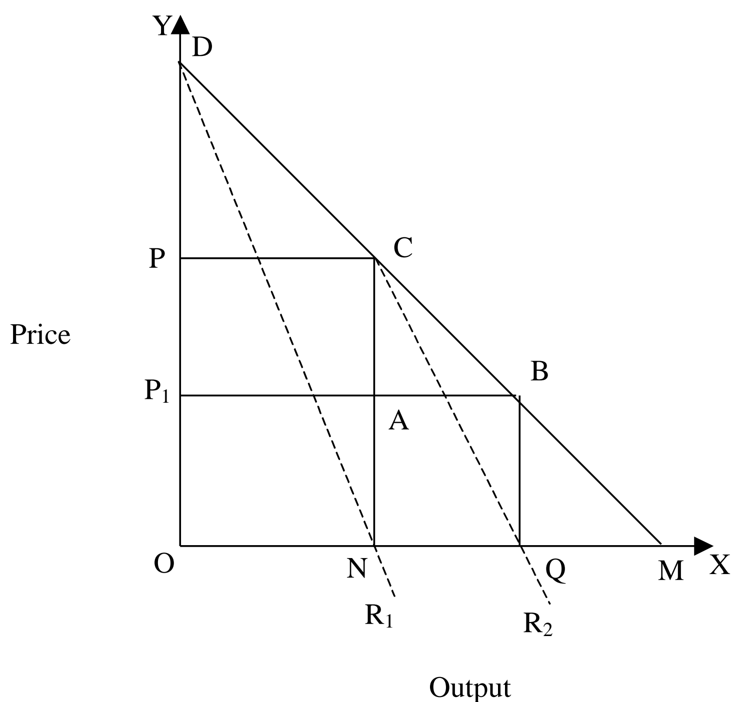


Figure 13.4

In the figure 13.4, the demand curve confronting the two sellers of mineral water is the straight line DM. Suppose ON = NM is the maximum daily output of each mineral spring. The total output of both is ON + NM = OM. It will be seen from the figure that if the total output of OM is offered in the market for sale, the price will be zero. If there were perfect competition, the long run equilibrium price would have been zero and the actual output produced would be zero. If two producers produce the maximum quantity OM, the price would become zero. Cournot assumes that the first producer Mr. X starts production without the second Mr. Y getting into the field. The first producer Mr. X will produce that quantity which will maximize his profit. Under profit maximization formula (MR = MC) he will produce ON, i.e., OM quantity of mineral water and fix the price at OP. The maximum profit would be ONCP as shown in the figure. Now the second producer Mr. Y gets into the field and finds that his share of the demand curve is CM and that he could maximize his profit by taking CR2 as the marginal revenue curve. So, Mr. Y will produce NQ quantity, i.e., NM, for it is at this output his MR is equal to MC. The price fixed by him is OP1. The total output of the two sellers now will be ON + NQ, i.e., OQ. Which is of the output of the two springs. Since the second producer has brought down the price to OP_1, the first producer Mr. X should also bring down the price to OP_1. He cannot sell at a higher price since the product is homogeneous and identical. The total profit with price OP_1 will

be OQBP1 consisting of $ONAP_1$ for Mr. X's share and NQBA for Mr. Y's share. From this, the anticipating profit for Mr. X has come down from ONCP to $ONCP_1$ because of the second producer fixing it at OP_1. But Mr. X anticipating the shift in demand curve downward fixes the price at a level in between OP and OP_1 where his output will be less than what it was before. This price situation would bring more profit for both and with the change in proportion of each share in the output, the two producers will come to equilibrium finally. According to Cournot's model the final stage is achieve when the rivals produce two thirds of the total output, each contributing one-third of the total.

Chamberlin's Model

Chamberlin's modified of Cournot proceeds with the same assumptions and with the entrance of Mr. Y and the reduction of price from OP to OP1 both models make no difference. But afterwards Chamberlin's analysis is different. With entrance of Mr. Y the producer Mr. X realizes the importance of mutual interdependence of the two and the necessity of sharing monopoly profit of ONCP. So, he reduces his output by half while Mr. Y maintains his output at NQ. Thereby the two rivals produce only QQ, monopoly output and the price is fixed at OP and the monopoly profit is shared equally. In Chamberlin's solution there is stability.

NOTES

LESSON -14

ECONOMIC LIBERALIZATION

Economic Liberalization:

Economic Liberalization has led to more deregulation, liberalization and privation of some of the public sector undertakings in India. This has resulted in the shares of some of the public sector undertakings being made available to the public. The Industrial policy adopted by the government earlier did not allow investment in core sector by either individuals or private sector. But with the privatization of some of the public sector undertakings, the shares are now available to the public for contribution. Recently, the shares of VSNL were bought by TATAs.

LPG Model of Development

LPG model of development which was introduced in 1991 by the then Finance Minister Dr.Manmohan Singh with a big bang was intended to charter a new strategy with emphasis on Liberalization, Privatization and Globalization (LPG). Several major changes at the domestic level were introduced.

Firstly, areas hitherto reserved for the public sector were opened to private sector. The Government intended to transfer the loss-making units to the private sector, but it failed because there were no takers for them. Instead, the government started disinvestment of the highly profit-making PSUs and the proceeds were used to reduce fiscal deficits. Thus, due to various social constraints the Government could not carry forward its programme of privatization, though it did succeed in liberalizing the economy to the private sector both - both domestic and foreign.

Secondly, by permitting the private sector to setup industrial units without taking a license, the Government removed certain shackles which were holding back or delaying the process of private investment.

Thirdly, by abolishing the threshold limit of assets in respect of MRTP companies and dominator undertakings, the Government freed the business houses to undertake investments without any ceiling being prescribed by the MRTP Commission. Obviously, considerations of promoting growth were more dominant with the Government and such issues as concentration of economic power took a back seat.

Fourthly, with a view to facilitate direct foreign investment, the Govern decided to grant approval for direct foreign investment up to51 percent equity, but such proposals would require prior clearance of the Government. No permission was required for indigenously developed technologies etc.

Fifthly, chronically sick public sector enterprises were referred to the Board for Industrial and financial Reconstruction (BIFR) for the formulation of revival rehabilitation schemes. A social security mechanism was introduced to protect the interests of workers likely to be affected by such rehabilitation packages.

Sixthly, to improve the performance of public sector enterprises, greater autonomy was given to PSU managements and the Boards of public sector companies were made more professional.

Lastly, the economy was opened to other countries to encourage more exports. To facilitate the import of foreign capital and technology and other allied imports, reduction in important duties and other barriers were brought about.

LPG Model of development emphasises a biggest role for the private sector. It envisages a much larger quantum of foreign direct investment to supplement our growth process. It aims at a strategy of export led growth as against import substitution practiced earlier. It aims a reducing the role of the state significantly and thus abandons planning fundamentalism in favour of a more liberal and market driven pattern of development.

Globalization ands Its Impact on India

"Our primary concerns are that globalizations should benefit all countries and should raise the welfare of all people throughout the world. This implies that it should raise the rate of economic growth in poor countries and reduce world poverty, and that its should not increase inequalities or undermine socio-economic security within countries"

- World Commission on the Social dimension of Globalization (2004)

"Globalisation means free movement of capital, goods, technology, ideas and people. Any globalization that omits the last one is partial and not sustainable."

- Branko Milanovic

Globalization is the process of integrating various economies of the world without creating any hindrances in the free flow of goods and services, technology, capital and even labour or human capital. The term 'globalization' has, therefore, four parameters:

(i) Reduction of the trade barriers to permit free flow of goods and services among nation-states;

(ii) Creation of environment in which free flow of capital can take place among nation-sates;

(iii) Creation of environment, permitting free flow of technology; and

(iv) Last, but not the least, from the point of view of developing countries, creation of environment in which free movement of labour can take place in different countries of the world.

The advocates of globalization, more especially from developed countries, limit the definition of globalization to only three components, unhindered trade flows, capital flows and technology flows. They insist developing countries to accept their definition of globalization and conduct the debate on globalization within the parameters set by them. However, several economists in the developing world believe that this definition is incomplete and in case the ultimate aim of globalization is to look upon the world as a 'global' village, then the fourth component, unrestricted movement of labour cannot he left out. But the entire issue whether debated at the World Bank, IMF or World Trade Organization (WTO) blacks out 'labour flows' as an essential component of globalization. More recently the report of the World Commission of Social Dimension of Globalization (WC SDG) setup by the ILO has taken note of the question of human capital flows and their role in helping developed countries. This has raised several questions which will be taken up later.

Thus, basically globalization signifies a process of internationalization plus liberalization. According to Stiglitz, "Globalization is the closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of costs transportation and communications, and the breaking down of artificial barriers to the flow of goods and services, capital, knowledge, and (to lesser extent) people across borders." (Stiglitz 2002b, pp. 9) Jagdish Bhagwati defines globalization in the following words: "Economic globalization constitutes integration of national economies into the international economy through trade, direct foreign investment (by corporations and multinationals), short-term capital flows, international flows of workers and humanity generally, and flows of technology".

Advocacy of Globalization

Advocates of globalization support their defense of globalization on the following arguments:

(i) Globalization will promote direct foreign investment and, thus, it enables developing countries to raise capital without recourse to international indebtedness.

(ii) Globalization enables developing countries to make use of technology developed by advanced countries without investment in Research and Development.

(iii) Globalization widens the access of developing countries to export their produce in the developed countries. Simultaneously, it enables the consumers of developing countries to obtain quality consumer goods, especially consumer durables, at relatively much lower prices.

(iv) Globalization introduces faster diffusion of knowledge and thus enables developing countries to raise their level of production and productivity. It, therefore, generates the momentum to reach international standards of productivity.

(v) Globalization reduces costs of transport and communication. It also reduces tariffs and thus enlarges the share of foreign trade as a percentage of GDP.

In nutshell, globalization is considered as the engine of growth, technical advancement, raising productivity, enlarging employment and bringing about poverty reduction along with modernization.

Global Business Environment:

The claims of the protagonists of globalization have been examined by various researches in different countries. A very powerful critique of globalization has been made by Stiglitz, Nobel Prize winner of Economics (2001) and former chief Economist of the World Bank. The World Commission on the social Dimension of Globalization (WCSDG) set up by ILO has also considered the experience of globalization of the world over and made certain very revealing observations.

The World Commission states: "The current path of globalization must change. Too few share in its benefits. Too many have no voice in its design and no influence on its course". (ILO, 2004, p.2)

"We wish to make globalization a means to expand human well-being and freedom, and to bring democracy and development to local communities where people live". (ILO, 2004, p. 2)

Globalizers advocated the acceptance of the new strategy of liberalization and globalization on the plea that India will be able to access foreign market more effectively.

This underlines the hard reality that foreigners have been able to penetrate the Indian market more effectively than Indians have been able to access foreign markets.

However, India's performance in achieving a net positive balance in invisibles has helped it to wipe out the large trade deficit.

Foreign investment takes two forms - foreign direct investment (FDI) and foreign portfolio investment (FPI). Foreign direct investment helps to increase

the productive capacity of the economy, while foreign portfolio investments is of a more speculative nature and is thus very volatile.

Outlining the objectives of globalization, ILO Report states: "Our primary concerns are that globalization should benefit all countries and should raise the welfare of all people throughout the world. This implies that it should raise the rate of economic growth in poor countries and reduce world poverty, and that it should not increase inequalities or undermine socio-economic security within countries." (WCSDG, 2004. p. 35) In that sense, the world should move towards more "humane globalization."

This is a realizable vision. The resources exist to overcome the most pressing problems of poverty, disease and education. Mahatma Gandhi put it very simply: "There is enough in the world for every body's need but there cannot be enough for everybody's greed."

However, globalization has not worked for the interests of the world's poor. It has led to increase in inequalities across the countries as well as within the countries. It is not working to sustain environment. The transition from communism to market economy or from highly regulated states to market economy has been so badly managed that, but for china, Vietnam and a few other countries in Eastern Europe, poverty has soared as incomes have plummeted. The fault does not lie in globalization, but the way it has been managed. ILO Report sums up the situation: "The economy is becoming increasing global, while social and political institutions remain largely local, national or regional."

Wide international consensus exists on essentials which all countries must strive for:

- Good political government based on a democratic political system, respect for human rights, the rule of law and social equity.
- An effective state that ensures high and stable economic growth, provides public goods and social protection, raise the capabilities of the people through universal access to education and other social services, and promotes gender equity.
- A vibrant civil society, empowered by freedom of association and expression, that reflects and voices the full diversity of views and interests. Organizations representing public interests, the poor and other disadvantaged groups are also essential for ensuring participatory and socially just governance.
- Strong representative organizations of workers and employers are essential for fruitful social dialogue.

The highest priority must be gives to policies to meet central aspiration of women and men for decent work, to raise the productivity of the informal economy and to integrate it into the economic mainstream; and to enhance the competitiveness of enterprises and economies. So far globalization has helped to create an increasingly global economy, but it has not succeeded in creating a global community with commonly shared goals. Thus there is a need for a more fair and inclusive globalization.

NOTES

LESSON - 15

GATT, WTO - FLOW OF FOREIGN CAPITAL

GATT

The General agreement on Tariff and Trade GATT was established in 1948 in Geneva to pursue the objective of free trade in order to encourage growth and development of all member countries. The principal purpose of GATT was to ensure competition in commodity trade through the removal or reduction of trade barriers. The first seven rounds of negations conducted under GATT were aimed at simulating international trade through reduction in tariff barriers and also by reduction in non tariff restrictions on imports imposed by member countries. GATT did provide a useful forum for discussion and negotiations trade issues.

The 8th round of Multi-lateral Trade Negotiations, popularly known as Uruguay Round (since it was launched at Punta del Este in Uruguay) was started in September 1986 at a special session of GATT Contracting parties held at Ministerial level. World trade had undergone a structural change during the four decades since the establishment of GATT in 1948.

The GATT agreement stipulates that anti-dumping proceeding will be terminated if the volume of dumped imports from a particular country is less than 1% of the domestic market. The only exception is less than 1% of the dumping countries collectively account for more than 2.5percent of the domestic market. Anti-dumping proceedings will be terminated if the margin of dumping is less than 2%. These clauses do help India to protect its exports from antidumping investigations. It would have been much better for India, had the figure of dumped imports as a share of domestic market been more than 1%.

Some critics are of the view that Trade-Related Intellectual property Rights (TRIPs) as embodied in the GATT agreement will have disastrous effects on our economy, more especially in two vital areas i.e., pharmaceuticals and agriculture.

Both these areas affect the well-being of the people.

Trade Related Investments Measures (TRIMs) were initiated by US in 1980 since it was losing ground in competition in goods to Japan and other newly industrialised nations of East Asia and intended to recover its lost ground through trade in services. Although GATT had never discussed the idea of trading in services as part of the earlier seven rounds of negotiations, the USA tried to sell this idea in the 8th Round of GATT negations. The principal objective was to benefit the Multinational Corporation (MNCs) so that they

could undertake investment in financial services, telecommunications, and marketing so as to boost world trade.

There is no doubt that in a world of unequal partners, multilateralism is superior to bilateralism and if some concessions are to be extracted from strong partners belonging to US and European Community, then the combined strength of the developing countries can exercise a stronger of their favour. One redeeming feature of the GATT is that there is the principle of one country, one vote. However, the developed countries by various new devices, more especially through intellectual property rights and TRIMs. Although the Government of India is claiming that very substantial benefits are likely to accrue as a consequence of GATT agreement, but it is premature to reach any definite conclusion.

The history of GATT reveals that whenever newly industrialised nations have challenged the competitive strength of the developed Countries, they have immediately retaliated by imposing both tariff and non-tariff batteries. They have now enlarged these in the form of TRIPs and TRIMs. The innovation of the social clause was also conceived with the same intention of blunting the competitive advantage of developing nations. This game will continue. The solution lies in the fact that the developing nations should advantage of the multi-lateral trade organisms and show their combined strength by closing their ranks, rather than surrender their sovereignty one after another. To say that there is no alternative is a defeatist solution. Now that china has also been admitted to WTO, both China and India should work together to assert a fair and just treaty among the trading partners of WTO, rather than pushing down the throat of the weak, the will of the strong partner(s).

The World Trade Organism (WTO):

The World Trade Organism (WTO) as contained in the Final act was established on 1st of January 1995 and India became a founder member of WTO by ratifying the WTO agreement on 30 December 1994. According to the Estimates prepared by the World Bank, OECD and GATT Secretariat, the overall trade impact as a consequence Uruguay Round Package will be additional to the merchandise good by $745 billion by the year 2005. The GATT Secretariat further projects that the largest increase will be in the area of clothing (60%), agriculture, forestry and fishery products (20%) and processed food and beverages (19%). But the Economic Survey (1994-95) has underlined the stark reality that whereas the developed countries want that under the pressure of the super-statal organization (WTO), the developing countries should reduce trade barriers and permit free flow of goods, they themselves

want to pursue protection it policies to save their interest by erecting trade barriers.

India, being a founder member of the WTO, a has been following the WTO decisions, but as a consequence certain effects on the Indian economy have become evident.

WTO has been urging India to lower import duties, remove controls on consumer goods imports, reduce quantitative restrictions, etc. Under the Uruguay Round Agreement, India offered to reduce tariffs on capital goods, components, intermediate goods and industrial raw materials to 40% in case our tariffs were between 25 to 40 per cent and to bind the tariff ceiling at 25 percent in case our tariffs were below that percentage. This reduction in tariffs was to be achieved by the year ending 2000.

The United States has signed WTO agreements with the proviso that all such agreements will have to be passed by the US Congress, being a sovereign body. There is another assurance given by the US President to the Congress. In case, the decisions of Dispute Settlement Machinery of WTO go against the United States, they will be reviewed by US justices. If they find the decisions unfair, the US has unilaterally reserved for itself right to walk out of the WTO.

Criticizing this big brother like attitude, some commentators believe that the rule makers are not going to tolerate being over-riled. Many of the US laws like section 301 of US Trade Act is clearly a violation of WTO agreement. This matter was considered by the Dispute Settlement Panel of WTO which gave its verdict that those laws are WTO complaint. This has emboldened the US administration as complaint with US trading interests.

WTO Agreement on Agriculture stipulated that developed countries would reduce their subsides by 20 percent in six year and developing countries by 13 percent in 10 years. But as facts stand today, developed countries tried to circumvent this agreement by providing Green box and Blue Box subsidies to support agriculture.

Green box subsidies include amounts spent on Government services such as research, disease control, infrastructure and food security. They also include payments made directly to farmers that do not direct income support assistance to help farmers restructure agriculture, and direct payments under environmental and regular assistance programmes. This definition is very wide and includes all types of Government subsidies.

Blue Box Subsidies are certain direct payments made to farmers where the farmers are to limit production, certain government assistance programmes to encourage agriculture and rural development in developing countries, and other support on a small scale when compared with the total value of the

products supported 15 per cent or less in the case of developed countries and 10 per cent or less for developing countries.

"In the real world, as distinct from the imaginary or inhabited by free traders, survival in agricultural in agricultural markets depends less on comparative cost advantage than on comparative access to subsidies. Liberalizing local food markets in the face of unequal competition is not a prescription for improving efficiency, but a recipe for the destruction of livelihood."

Earlier, Indian agriculture prices were lower than international prices mostly. But as a result of the heavy subsidization of agricultural exports by developed & centuries, that situation undertook a dramatic about -turn. Indian farmers have been put to serious disadvantages. The phenomenon of farmer's suicides and the growing interest in several states because of the distress of farmers specializing in agricultural commodities and their exports is a very serious human problem.

Flow of Foreign Capital:

Most countries of the world which embarked on the road to economic development had to depend on foreign capital to some extent. The degree of dependence, however, varied with the extent to which domestic economy in respect of technical progress, the attitude of the respective governments, etc. But the fact cannot be denied that foreign capital contributed in many important ways to the process of economic growth and industrialization. The need for foreign capital for a developing country like India can arise on account of the following reasons:-

(a) Domestic capital is inadequate for purpose of economic growth and it is necessary to invite foreign capital.

(b) For want of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign capital can show the way for domestic capital.

(c) There may be potential savings in a developing economy like India but this may come forward only at a higher level of economic activity. It is, therefore, necessary that foreign capital activity in the initial phase of development.

(d) It may be difficult to mobilize domestic savings for the financing of projects that are badly needed for economic development. In the early stages of development, the capital market is itself underdeveloped. During the period in which the capital market is process of development, foreign capital is essential as a temporary measure.

(e) Foreign capital brings with it other scarce productive factors, such as technical knowhow, business experience and knowledge which are equally essential for economic development.

It was only during the eighties that government relaxed its policy towards done specially in respect of investors from Oil Exporting Developing countries with a well-defined package of exemptions.

This was followed by Technology Policy Statement (TPS) in January 1983. The objective of the Policy was to acquire imported technology and ensure that it was of the latest type appropriate to the requirements and resources of the country. Under this policy, a number of policy measures were announced liberalizing the licensing provisions:

a. All but 26 industries were exempted from licensing in case of non-MRTP and non-FERA companies;

b. Private sector was allowed to participated in the manufacture of telecommunications equipment;

c. A number of electronic were allowed to manufacture electronic MRTP act;

d. Foreign companies were allowed to manufacture electronics components;

e. MRTP companies were allowed to set up industries in backward areas;

f. A number of new items were added to the list of industries allowed to be set up by FERA and MRTP units;

g. Broad banding of a license for a number of industries was allowed.

After the announcement of New Industrial Policy (1991, there has been an acceleration in the flow of foreign capital in India, As per data provided by the Government of India, during 1991-1992 to 2004-2005, total foreign investment flows were of the order of $85.7 billion. Out of which about $40.6 billion (47.4 per cent) were in the form of Foreign Direct Investment and the remaining $45.1 billion (52.6 per cent) were in the form of portfolio investment. This clearly shows that the performance of foreign firms was more in favour of portfolio investment. Moreover, out of the total direct foreign investments of the order of $40.6 billion, nearly 9.1 percent ($7.8 billion) was contributed by Non-resident Indians. Thus, the net contributed of foreign firms in direct investments was about 38 per cent of total foreign investments flows.

As a response to the policies of liberalization, the foreign investors were very keen to undertake portfolio investment, including GDR (Global Depository Receipts) and investment by Foreign Industrial Investors, Euro equities and others rose sharply from $244 million in 1992-93 to $3,824 million in 1994-95 and declined to $1,828 million in 1997-98. Portfolio investment

became negative in 1998-99 but again improved to $2.76 billion 2000-01, but again declined to nearly $1 billion in 2002-03 but touched a record level of 11.4 billion in 2003-04 and $9.3 billion in 2004-05.

NOTES

LESSON - 16

NEW GENERATION OF PRIVATE BANKS AND SCOPE (ICICI, HDFC, UTI, IDBI, INDUSIND BANK, BANK OF PUNJAB, CENTURION BANK) RECENT TRENDS IN GLOBAL BUSINESS

Introduction

Banking industry creates a chain of economic activity in the country. When a bank leads, it is followed b a number of activities. They are: Landing or Bank loan leads to - investment - production - employment - Income - Demand - Increase in prices - Increase in profit - more Divided - Demand for shares - expansion of capital market. With more banking activity, economic growth in the country will speed up leading to more economic development.

The economic implications of banking can be summed up as follows

a. removal of poverty

b. promotion of employment opportunities

c. Encourage savings

d. Promoting investments

e. Expanding money market by providing more short term loans and

f. Improving capital market

In India the private sector banks consist of the following categories:

i. Private scheduled banks.

ii. Private non-scheduled banks

iii. Foreign banks

This apart in the early stages of banking activity in India, native bankers called indigenous bankers in the unorganized sector. They are not permitted to undertake banking business presently. They also do not come under the provisions of Banking Regulations Act. Of these types, private scheduled banks are functioning on par with the other public sector banks in various respects. Since, they have been induced in the second scheduled of Restore Bank of India Act; they are enjoying the privileges as that of any other scheduled banks. These privileges importantly include refinance facility from RBI and participation in money market activities.

The commercial banks not included in the second schedule Banks. They are not entitled to get facilities like refinance and rediscounting of bills, etc. from RBI. They do not get the prestige like scheduled banks. RBI currently does not like scheduled banks. RBI currently does not encourage the opening of non scheduled banks.

The Foreign banks though not allowed liberally earlier, are now being welcomed, with the adoption of economic liberalization policy is our country. Prior to 1990, we had only limited foreign banks operating is our country, but now we have more number of foreign banks, thanks to the policy of economic liberalization.

Various banks are analyzed below

Industrial Credit and Investment Corporation of India (ICICI):

a. Origin :

The only developed bank which has participation by American and English investors is ICICI. This bank has been set up mainly to promote private sector undertakings in India. Initially, the industrially policy of the government was not in favour of the private sector. But subsequently the government started assisting the private sector through ICICI.

b. Capital :

It was started in 1955. Its authorized capital is Rs. 25 crores of which Rs.5 crores in ordinary shares of Rs.100 each was originally issued and paid up. Of these Rs.5 crores, Rs.3.5 crores by general was taken up in India. Rs.2 crores by banks, insurance companies and Rs.1.5 Crores by general public. Subscribers in the U.K. took up Rs.1 crore and in U.S.A. Rs.50 lakhs. At present, we have shareholders from U.K., U.S.A., Germany, France, and Japan. LIC is one of the largest shareholders.

c. Object:

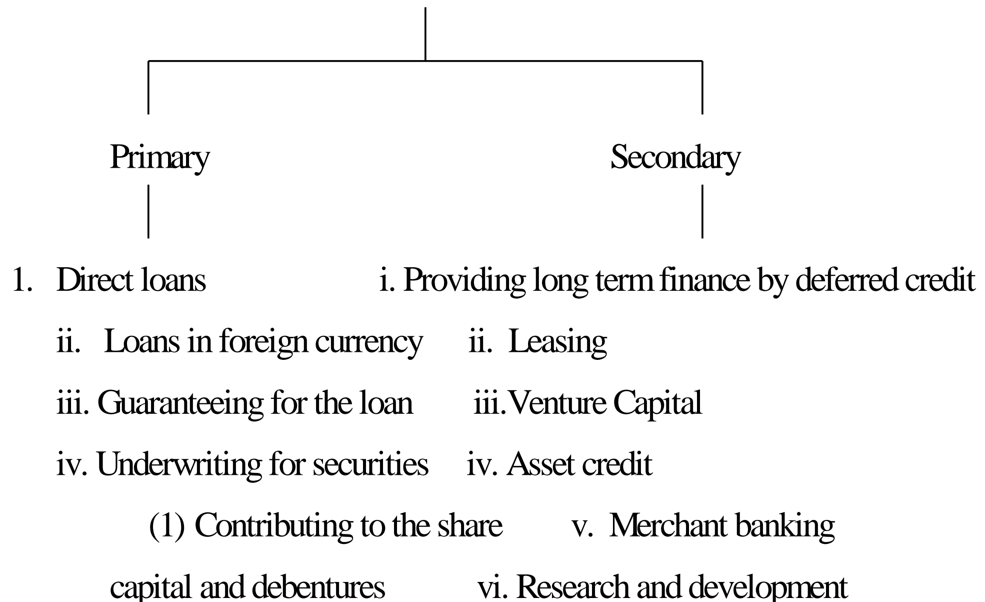
i. Assisting in the creation, expansion and modernization of private sector.
ii. Encouraging and promoting private capital participation
iii. Encouraging and promoting private industrial investment

d. Management:

The management of ICICI is the board of directories representing government, RBI, Foreign shareholders, and IDBI.

e. Functions:

The main functions of ICICI can be classified into primary and secondary functions.



Primary functions

I. Direct loans : ICICI has granted Rs.310 crores in 1981 which has gone up to Rs. 25,000 crores in 1998.

II. Loans in foreign currency : Foreign currency loans have also been granted to the tune of Rs. 63,900 crores as there are shareholders from U.K., U.S.A., Germany, and Japan as a result of which, the bank was able to raise more resources in foreign exchange.

III. Contributing for the share capital and debentures: Where ICICI cannot contribution direct loan, it has stood as a guarantor especially in obtaining foreign loan by private sector companies.

IV. Underwriting for securities: It has also contributed to shares and debentures of companies directly.

V. Guaranteeing for the loan: The bank has helped in the promotion of companies by underwriting their shares and debentures.

Secondary Functions

I. Providing long term by deferred credit: In secondary functions, the bank has given loan for purchase of capital equipment. The sellers of these capital both within country and outside are assisted in the form suppliers credit.

II. Leasing: Many private sector concerns are helped to purchase huge capital-oriented machinery due to the finance provided by ICICI.

III. **Venture capital:** Promoting risky industry ventures which are based on sophisticated technology are financed under venture capital. The borrowers who are interested in buying assets on installment basis are provided loan facility under the guarantee given by the ICICI. The title of the goods will be transferred on the last installment paid by the borrower.

IV. **Asset credit:** It helps in procuring assets through self liquidating loans.

V. **Merchant banking:** As a part of promoting more industrial concerns, merchant banking is also undertaken by ICICI and it was started in 1973. ICICI has also promoted housing loan by starting Housing Development Finance Corporation (HDFC).

f. Special Assistance:

I. It provided more loans in foreign currency and it is the only institution which is given maximum foreign currency loan.

II. It provides technical assistance in collaboration with foreign concerns.

III. It has undertaken commercial banking activity by starting ICICI Bank.

IV. It also has its own mutual funds.

g. Institutions promoted by ICICI

(i) Credit Rating Information System of India Limited (CRISIL): It is a credit rating agency set up by ICICI for rating the services of corporate sector.

(ii) Technology Development and Information Company of Limited (TDICI): For financing the transfer and up gradation of technology of the borrowing concerns.

(iii) Industrials Financial Marketing Research (IFMR): To undertake research activity in financial management.

(iv) ICICI Securities and Finance Company Limited: This was incorporated in New York and it plays an important role in corporate finance.

(v) ICICI Brokerage Service Limited: This is for undertaking securities broking activities.

(vi) ICICI Investors Service Limited: Its more a mutual fund.

Thus ICICI has been playing an important role towards industrial growth of the country.

Industrial Development Bank of India (IDBI)

a) Origin

For all the development banks in India, the Apex institution to guide and promote in the field of industrial is the Industrial Development Bank of India. This was started initially as a subsidiary as a subsidiary bank of RBI in July

1964. But subsequently, by 1976 it became an independent and autonomous bank.

b) Capital

The bank was started with initial capital of Rs. 100 crores which was subsequently raised.

c) Object

The main object of IDBI are:

i. To promote rapid and balanced industrial growth in the country

ii. Guiding in the field of industrial refinance by coordinating with other development banks.

iii. Providing technical guidance and administrative assistance in the promotion of industries.

iv. Undertaking market and investment research for development of industries.

d) Management

The board consists of 14 directors, headed by a chairman. They are represented from different field of industry.

Housing Developing Finance Corporation (HDFC):

Introduction:

With the increasing population, the Ninth Five Plan (1997-2002) of the government of India adopted a national housing policy and allocated a sum of Rs. 150 crores for providing housing facilities to the people. According to National Building Organization, the demand for housing was estimated to be 20 lakhs houses per year. At present, there is a shortfall of 2 crores houses, of which 1.3 crore houses are in rural areas and .07 crore are in urban areas.

It is only in the housing industry we can generate maximum employment. By constructing 20 lakhs houses per year, we could generate one crore employment directly and 1.5 crores employment indirectly. In view of such significance, it is no wonder that the Ninth Five Year Plan attached so much importance to housing schemes.

Capital and Management

In the year 1977, housing Development Finance Corporation (HDFC) was incorporated with the main object of promoting home ownership by providing long-term loans. It was promoted as a company with an initial share capital of Rs. 10 crores. As the operating income of the steadily, its profits have also gone up. As on 2001-02,its profit after tax is 580 crores. As on 31.3.2002, its share capital is Rs.121.7 crores and Reserve and Surplus stand at

Rs.2581.14 crores. The present book value per share is Rs. 222 as against a face value of Rs.10. The divided declared is around 76 per cent.

HDFC is managed by board of directors, consisting of 15 persons, representing government, financial institutions, constructing industry and other representatives of the public.

HDFC as a Housing Finance Institution

The performance of HDFC is evident from the fact that the World Bank has considered HDFC as a model private sector housing finance company in developing countries. It is also regarding HDFC as a model institution for providing technical assistance for new and existing institution both in India and abroad. The executives of HDFC have undertaken consultancy assignments relating to housing and urban development on behalf of multinational agencies allover the world.

Main Objects of HDFC

1. To increase the number of residential houses in the country by providing housing finance in a systematic and professional manner.
2. To promote home-ownership.
3. To increase the flow of funds housing sector.
4. Strengthening housing finance by improving domestic financial market and financial services.
5. Developing close relationship with individual households, i.e., providing direct housing loans to individuals.
6. To maintain its position its position as the premier housing finance institution in the country.
7. To transform various ideas into viable and creative solutions. That is, building houses on the basis of costs, utility and modernization.
8. To provide consistently high returns to shareholders.
9. Diversifying activities to client-base by entering into mutual funds, leasing, commercial banking, insurance, etc.
10. To align with the national priorities and adopt flexible housing finance policy by providing more house weaker sections of the society.

Various activities promoted by HDFC (Various types of Loan offered by HDFC)

In order to provide housing finance, HDFC is giving the following types of loans to individuals:

1. **For Dwelling houses:** Loans are given to individuals, based on their income. Loans are repayable for a maximum period of 20 years.

2. **Extension of existing houses:** Existing small houses could be extended, either by constructing vertically or by extending horizontally.
3. **Purchase of Land:** Purchase of land or plots for constructing houses.
4. **Repair / Renovation:** For undertaking repairs in an existing house or for modernization.
5. **Large scale construction:** For constructing large scale housing, under Group housing or for employees of a particular organization on the basis of collective responsibility.
6. **Providing housing facility to people** belonging to the weaker sections of the society through low-cost hunting, by using hollow-blocks for construction.

Social responsibilities of HDFC

1. One of the key activities of HDFC is promoting Shelter Assistance Reserve. It is a multi-purpose development fund with object of promoting projects undertaken by non-government organizations (NGOs), community groups and local bodies.
2. Through a geographical coverage, the above fund is utilized for developing assistance in rural, urban and semi-urban areas.
3. Community development activity such as health and medical activities, education, women empowerment, child welfare, improving the economic condition of the physically handicapped and mentally disabled persons.
4. Undertaking research in infrastructure development, assisting institutional development.
5. Helping in the event of natural calamities.
6. Environmental issues, issues relating to senior citizens, heritage, sports event for the above mentioned people and animal welfare.

Help for Natural calamities

HDFC has provided housing and infrastructural support to the victims of natural calamities. Through various innovative financial mechanisms, assistance is being given and the loan recovery has been as high as 98% . These loans are utilized as a revolving fund for financing similar housing projects and interest earnings are used for supporting NGOs involved in developmental activities, benefiting households or economically weaker sections.

Subsidiaries promoted by HDFC

The following are the subsidiaries promoted by HDFC -

1. HDFC Bank
2. HDFC Mutual Fund

3. HDFC Standard Life Insurance Company Ltd.
4. HDFC Securities
5. Internet Global Services Ltd.
6. Credit Information Bureau (India) Ltd.

Special Features of HDFC

1. Loans are granted for individuals up to a maximum of Rs. 1 crore repayable within 20 years. This will come under Home extension loan.
2. Home improvement loan can be obtained either individually or jointly. Here also loan is sanctioned upto Rs. 1 crore.
3. Short-term building loan can also be applied for a maximum period of 24 months.
4. HDFC home equity loan is available for the owners of current property. Here, loan is available to a maximum of 50 lakhs and minimum of Rs. 1 lakh. But the market value of the dwelling unit should be at least Rs.10 lakhs.
5. Land purchase loan: Under this, finance is provided for acquiring land with comfortable repayment option.

Conclusion:

HDFC the leading private sector housing finance institution in India has not only gone a long way in providing finance for constructing individual houses but has also helped in creating more employment opportunities.

Unit Trust of India (UTI)

Introduction

On the lines of Investment Trust started in UK, the Indian Government also wanted to promote an investment trust which can attract the savings of middle and lower income group people. In fact, the government wanted to provide the benefits of profits earned by joint stock companies to middle and lower income group people who cannot directly invest in these companies. So in 1964, Unit Trust of India Act was introduced in parliament by the then Finance Minister Sri T.T. Krishnamachari and thus UTI came into existence. It commenced its operations in July 1964. It is the first mutual fund of the country.

Structure and Management of UTI

The Initial capital of UTI was Rs. 5 crores and this was contributed by 5 institutions, namely, RBI, SBI, LIC, Scheduled banks and foreign banks.

The management was entrusted to an independent Board of Trustees which February 1976. All the institutions mentioned were provided

representation on the Board of Trustees by UTI. As per the United Trust of India Act, the Chairman of the Board will be appointed by government of India. The board of trustees oversees the general direction and management of the investment trust. The main object will be to invest the funds on commercial principle, keeping in mind the interests of the investors. Since UTI has no share capital, it operates on the basic principle of 'no profit-no loss' basis. A nominal amount from the operating profits towards operating expenses.

Investment polices of UTI

1. **Prudential Exposure Norms:** As per the Act, the investment decisions of UTI are guided by the interest of the investors. Its investments are subjected to prudential exposure norms, i.e., it cannot invest more than 10% of a particular scheme corpus in the equity of any one company.
2. **Investment decisions:** Investment decisions are backed by inputs from independent groups set up for equity research and investment appraisal.
3. **Confidence of inventors :** confidence is kept high by periodical publication of the value of units and their purchase price.
4. **Liquidly schemes:** Liquidly Schemes such as the open-ended funds provide opportunities to the investors to sell their units to UTI and encash them so that they can meet their immediate cash requirements.
5. **Reasonable Returns:** For the units invested by the public, a reasonable return is assured. UTI has been providing a reasonable return for a long time. It us only in 2002, it could not uphold this principle.
6. **Category of investors:** The investments opportunities are open to individual investors, trusts, societies, firms, public sector undertakings (PSUs), financial institutional, corporate bodies, Defence Services Fund, banks and NRI investors.
7. **Tax Benefits:** Certain schemes are meant for people who come under higher income brackets and who can claim tax benefits for the income received from UTI.
8. **Government policy of investment:** Since UTI is the brain child of the government; it promotes essential industries by investing in their shares and debentures. Transport, electricity and petroleum companies are some of the industries in which UTI has invested the unit funds.
9. **Promotion of new companies:** By way of promoting new companies, UTI has not only ear-marked certain percentage of its corpus funds, but has also been the underwriter of these companies.

Details of various product varieties open to investors

By way of operating for different categories of investors, UTI offers an ever expanding product range. The range includes the following-

1. **Unit Scheme 64:** The first product introduced by UTI was 'United Scheme 64'.
2. **Monthly income plan:** This scheme is meant for the benefit of regular income needs of retired persons and women.
3. **Education:** To meet the cost of higher education and career plans for children, 'Children's college and Career Fund' was established.
4. **Girhalakshmi unit plan:** This is mainly meant for future wealth and income needs of women.
5. **Retirement benefit plan:** This plan is meant for wealth accumulation to meet post retirement income needs.
6. For high net worth investors and liquid funds - Unit Scheme 1995, UTI Bond Fund and UTI Money Market Fund were started.

Investor Mobilization

The main objective of UTI lies in attracting individual investors. Individual household investors account for 99% of UTI inventors' account and 65% of unit capital of UTI schemes. In order to attract investors, UTI has 67,000 commission-based canvassing agents. These agents are trained to explain the products an provide related service support to investors.

Other developments in mobilizing investors

1. **Technology up gradation programme:** This involves networking of online computer system in all UTI offices. By this, the quantity of the service will improve.
2. **Touch screen kiosk:** A touch screen kiosk was inaugurated in October 2001. The kiosk is a small air-conditional room with a computer, wherein by a finger touch, the investors can know more information about UTI schemes, such as NAV, sale, repurchase price, product details and portfolios.
3. **Online investor query:** Details on the investment made with UTI, interfacing with investor database on various schemes are given, based on browser-based queries.
4. **Generic system database:** Here, integration with the completed data migration of all the schemes will be made for enabling the investing public to do online financial transactions such as sale, transfer,

repurchase etc., of units through the use of personalized smart cards, debited cards and credit cards.

5. **Public information through print media:** UTI publishes weekly and daily NAV for all its listed schemes offers a prospectus for every scheme. It also publishes half yearly results for all schemes and releases information on portfolio. It is also adhering to the 'Disclosure' requirements, specified by SEBI.

Subsidiary Companies of UTI

Along with Investment Trust, UTI has started a number of other companies by way of strengthening the financial services including underwriting. These companies are

1) UTI Bank Ltd, established in 1994 -the first private sector bank under RBI guidelines.
2) UTI Securities Exchanger Ltd, 1994 - the first institutionally sponsored corporate stock broking firm.
3) UTI Investors Services Ltd, 1993 - the first institutionally sponsored Registrar and Transfer agency.
4) UTI Institute of capital Markets, 1989 - the first teaching institute in Asia.
5) UTI Investment Advisory Services Ltd 1988 - the first Indian investment Advisor registered with SEC, USA.

UTI (Transfer of Undertaking and Repeal)bill 2002

The Unit Trust of India (Transfer of Undertaking and Repeal) act replaces the ordinance promulgated earlier to provide for transfer and vest the undertaking, excluding the specified undertaking of the UTI, to the specified company to be formed and registered under the Companies Act, 1956.

This Act also seeks to transfer and vest the specified undertaking of the UTI in the Administrator besides repealing the Unit Trust of India Act, 1963 in order to corporatise the UTI and let it compete in the free market economy.

Conclusion

As stated already, the government has come out with a scheme to bail out Rs.60,000 crores investment funds of UTI by dividing UTI into parts, consisting of

a) Assured Fund ; and b) NAV based.

It is a pity that the first mutual fund of the country has to face such a situation of restructure, owing to its poor financial condition. The main reason for such a situation is the wrong investment policy of the UTI. While private mutual funds are able to function successfully within a short period, UTI with a

vast experience has no reason to face such a critical situation. It is time the government took up some serious steps as it involves the savings of middle of middle and lower income group people. In a developing economy, the promotion of a savings and investment for productive purpose is an important role of the government and the government should bear this in mind and act accordingly.

Industrial Development Bank of India (IDBI)

a) Origin

For all the development banks in India, the Apex institution to guide and promote in the field of industrial finance is the Industrial Development Bank of India. This was started initially as a subsidiary bank of RBI in July 1964. But subsequently, by 1976 it became an independent and autonomous bank

b) Capital

The bank was started with initial capital of Rs. 100 crores which was subsequently raised

c) Object

The main objects of IDBI are:

i. To promote rapid and balanced industrial growth in the country

ii. Guiding in the field of industrial refinance by co-ordinating with other promotion of industries.

iii. Providing technical guidance and administrative assistance in the promotion of industries

iv. Undertaking market and investment research for development of industries.

d) Management

The board consists of 14 directories, headed by a chairman. They are represented from different fields of industry.

e) Special Assistance

a) Direct finance

i. Project loan: For any new projects, IDBI grants loan according to the economic, technical, financial and managerial viability of the project.

ii. Underwriting of securities: Banking or any other financial securities will be contributed by IDBI. In addition, the securities of newly promoted companies will also be preferred for underwriting.

iii. Soft loan: Long term loan for the purchase of capital equipment at concessional rate of interest with easy terms of repayment are provided.

iv. **Technical development fund loan:** For the purpose of modernization, a technical development has been set up which will be used for modeling industrial concerns

v. **Equipment finance:** For the promotion of power generation and distribution in the country, loans will be given to electrical power generating units. Of late, there is more privatization of electrical power generation companies and the will receive more assistance from IDBI.

b) Indirect finance

(a) Refinancing: Most of the state finance corporations and other financial institutions will receive refinancing facilities from IDBI.

(b) Rediscounting of bills: Bills discounted by commercial banks belonging to industrial houses or industrial concerns will be rediscounted by IDBI.

(c) Providing seed capital to new entrepreneurs: For the benefit of newly started companies, seed capital is provided so that their initial requirements can be me.

f) Institutions promoted by IDBI

IDMI has also promoted

a) Venture capital fund

b) Merchant banking

c) Debenture trusteeship

d) Equipment finance scheme

It has also promoted a separate board for the promotion if small scale industries. Of late, it is concentrating more on sick industrial units as there has been upsurge in sick units the country.

The functioning of IDBI is to be highly appreciated. It is not only responsible for the promotion of industrial units. But it is also responsible for their modernization. IDBI has played a sterling role in improving the condition of sick units and in the promotion of backward areas. If there has been development in the field of infrastructure, ii is mainly due to IDBI. In this way, the industrial growth of the country has been large contributed by IDBI. It has also helped in the promotion of exports.

IndusInd Bank

IndusInd Bank derives its name and inspiration from the Indus Valley civilisation - a culture described by National Geographic as 'one of the greatest of the ancient world' combining a spirit of innovation with sound business and trade practices.

Mr. Srichand P. Hinduja, a leading Non-Resident Indian businessman and head of the Hinduja Group, conceived the vision of IndusInd Bank - the first of the new-generation private banks in India - and through collective contributions from the NRI community towards India's economic and social development, brought our Bank into being.

The Bank, formally inaugurated in April 1994 by Dr. Manmohan Singh, Honourable Prime Minister of India who was then the country's Finance Minister, started with a capital base of Rs.1,000 million (USD 32 million at the prevailing exchange rate), of which Rs.600 million was raised through private placement from Indian Residents while the balance Rs.400 million (USD 13 million) was contributed by Non-Resident Indians.

A NEW ERA

The merger with the Bank in June 2004 of Ashok Leyland Finance Ltd., among the largest leasing finance and hire purchase companies in India, set in motion a process of consolidation through the combined customer base of the merged entity and its increased geographical penetration. IndusInd Bank has become one of the fastest-growing banks in the Indian banking sector today with its branch network expanding from 61 as on March 31, 2004 to 137 as on March 31, 2006 - reflecting an increase in excess of 125% in 24 months. The Bank has approximately 150 ATMs of its own, and has concluded multilateral arrangements with other banks with a total network of 15,000 ATM outlets. All the outlets of the Bank, including its branches and ATMs, are connected via satellite to its central database that operates on the latest version of IBM's AS400-720 series hardware and Midas Kapiti (now, Misys) software.

IndusInd Bank's broad lines of business include Corporate Banking, Retail Banking, Treasury and Foreign Exchange, Investment Banking, Capital Markets, Non-Resident Indian (NRI) / High Net worth Individual (HNI) Banking, and (through a subsidiary) Information Technology.

IndusInd Bank provides multi-channel facilities including ATMs, Net Banking, Mobile Banking, Phone Banking, Multi-city Banking and International Debit Cards. It was one of the first banks to become a part of RBI's Real Time Gross Settlement (RTGS) system. It has implemented an enterprise-wide risk management system encompassing global best practices in the area of Risk Management, with help from KPMG. This has enabled the Bank to remain in the forefront in complying with the requirements of Basel II. It is the first bank in India to receive ISO 9001:2000 certification for its Corporate Office and its entire network of branches.

With its roots in Indian tradition and emphasis on customer care, IndusInd Bank's service philosophy is well reflected in the communication tagline "We Care… Dil Se".

Mission

To emerge as an international bank with traditional roots

To acquire global capabilities

To provide world-class services

To maintain the highest standards of professionalism and integrity

Milestones

Year Business Achievements 2006-07

- Net worth crossed a milestone figure of Rs. 1000 crores at Rs. 1056 crores
- Successful completion of GDR issue of Rs. 145.96 crores
- Business Trunover touched a fugure of Rs 28.700 crores registering a growth of 18.14% over the previous year.
- Network of Branches increased to 170 along with 99 off-site ATMS, thus having presence in over 141 geographical locations spread over 27 States including Union Territories.
- Highest A1+ rating for its Certificates of Deposits by ICRA and Highest P1+ rating for its FDs by CRISIL.
- Bestowed with the prestigious IBA Award for technology implementation (STP).
- Added a number of new business and product lines, viz the launch of Indus GOLD and Indus Gift Card, E-Remittance facility, tie-up with number of Banks for ATM usage, tie-up with Religare Securities to extend Portfolio Management services and Bancassurance tie-up with Aviva Life Insurance

2005-06

- Ranked among the top ten banks in the country in the ET500 list of leading companies in India.
- Rated as "The best among the top 10 private-sector banks" in a survey covering 79 banks conducted by Business Standard in its November 2005 issue. Ranked sixth in the overall list, the Bank was also identified he "Most Efficient Bank" among all banks in India.
- Bestowed "India's Most Productive Bank" status by a Business Today-KPMG Survey
- Presented "Outstanding Achiever of the Year 2005- Corporate" (Runner up- Banking Technology Award) by IBA, Finance (from Infosys) and TFCI (Trade Fair and Conference International).

- Honoured with the "Award for Corporate social Responsibility (CSR)" at the India Brand summit 2005, Mumbai

2004-05

- Business Turnover crossed Rs. 22000 crores
- Network grew to 115 branches, 9 extension counters and 195 ATMs, spread over 95 geographical locations
- Bestowed with highest ratings for deposits from reputed rating agencies
- Highest rating "P1+" - on Fixed Deposits from CRISIL
- Highest rating "P1+" - on Certificate of Deposits from CRISIL
- Highest rating "F1+" - on Certificate of Deposits from Fitch Ratings India Pvt. Ltd.
- Bank's second International Representative office opened in London.
- 100th Branch opened at Dadar, Mumbai.
- Signed an Agreement with NCDEX as clearing banker.
- Launched International Mahila Card.

2003-04

- Total business volume touches Rs. 19,000 crores.
- Completes 10 years of banking excellence.
- Ashok Leyland Finance merges with the Bank.
- The first Indian Commercial Bank to achieve certification for its "Entire Network of Branches" under the ISO 9001:2000 Quality Management System.
- Launch of Debit Card- International Power Card.
- Bank's first International Representative Office in Dubai.
- One of the first banks to go live on RTGS platform.

2002-03

- One of th efirst banks to implement the RBI- Electronic Funds Transfer scheme.

2001-02

- Total business volume touches Rs. 14,000 crores. Highest productivity in the Indian banking sector with Rs. 16 crores of business per employee.

2000-01

- Total business volume crosses Rs. 10,000 crores

Bank of Punjab

Established in 1989, in pursuance of The Bank of Punjab Act 1989 and was given the status of scheduled bank in 1994. The Bank of Punjab is working as a scheduled commercial bank with its network of 266 branches at all major business centres in the country. The Bank provides all types of banking services such as Deposit in Local Currency, Client Deposit in Foreign Currency, Remittances, Advances to Business, Trade, Industry and Agriculture. The Bank of Punjab has indeed entered a new era of science to the nation under experience and professional hands of its management. The Bank of Punjab plays a vital role in the national economy through mobilization of hitherto untapped local resources, promoting savings and providing funds for investments. Attractive rates of profit on all types of deposits, opening of Foreign Currency Accounts and handling of Foreign Exchange business such as Imports, Exports and Remittances, Financing, Trade and Industry for working capital requirements and money market operations are some facilities being provided by the Bank. The lending policy of Bank is not only cautious and constructive but also based on principles of prudent lending with maximum emphasis on security. As agriculture is considered as backbone of our economy the Bank of Punjab has introduced "Kissan Dost Agriculture Finance Scheme" to small farmers.

Centurion Bank

1994 The company was incorporated on 30th June,1994 and the certificate of Commencement of Business on July 20th. It is promoted as a joint venture between 20th Century Finance Corporation Ltd, and its associates and Keppel Group of Singapore. It has got a network of ten branches. The main equity of the Bank was provided by the promoters, 20th Century Finance Corporation Ltd. & its associates and Keppel Bank of Singapore (now Keppel TatLee Bank Ltd.) through Kephinance Investment (Mauritius) Pte. Ltd.

1995 20th Century Finance Corporation Limited, has been amalgamated with Centurion Bank Limited. The Bank, set up in a fully computerized environment with ATM facility at every branch and Computer networking between branches can indeed claim to be a `Bank with a difference'.

The Bank has introduced, for the first time in the country, the concept of `anywhere banking' which enables to operate the account from any other branch of the Bank.

2005 Boards of Directors of Centurion Bank and Bank of Punjab Ltd on June 29, 2005 approves merger of two banks. The combined bank is now called Centurion Bank of Punjab.

Centurion Bank of Punjab is one of the leading new generation private sector banks in India. The bank serves individual consumers, small and medium businesses and large corporations with a full range of financial products and services for investing, lending and advice on financial planning. It holds leadership positions in the two-wheeler loan and commercial vehicle loan segments, is a strong player in foreign exchange services, personal loans, mortgages, education loans and agricultural loans, and credit cards. Additionally the bank offers a full suite of NRI banking products to overseas Indians. The bank also offers its customers an array of wealth management products such as mutual funds and life and general insurance.

Centurion Bank of Punjab operates on a strong nationwide franchise of 279 branches and 408 ATMs across 143locations and is supported by over 5,000 employees. In addition to being listed on the major Indian stock exchanges, the Bank's shares are also listed on the Luxembourg Stock Exchange.

Recently Centurion Bank of Punjab has announced a merger with Kochi based Lord Krishna Bank. The banks are awaiting regulatory approval from RBI.

Centurion Bank of Punjab is a new generation private sector bank offering a wide spectrum of retail, SME and corporate banking products and services. It has been among the earliest banks to offer a technology-enabled customer interface that provides easy access and superior customer service.

Centurion Bank of Punjab has a nationwide reach through its network of 393 branches/ECs, 452 ATMs 180 Locations. The bank aims to serve all the banking and financial needs of its customers through multiple delivery channels, each of which is supported by state-of-the-art technology architecture.

Centurion Bank of Punjab was formed by the merger of Centurion Bank and Bank of Punjab, both of which had strong retail franchises in their respective markets. Centurion Bank had a well-managed and growing retail assets business, including leadership positions in two-wheeler loans and commercial vehicle loans, and a strong capital base. Bank of Punjab brings with it a strong retail deposit customer base in North India in addition to a sizable SME and agricultural portfolio.

The shares of the bank are listed on the major stock exchanges in India and also on the Luxembourg Stock Exchange. Among Centurion Bank of Punjab's greatest strengths is the fact that it is a professionally managed bank with a globally experienced and capable management team. The day-to-day operations of the bank are looked after by Mr. Shailendra Bhandari, Managing

Director & CEO, assisted by a senior management team, under the overall supervision and control of the Board of Directors. Mr. Rana Talwar is the Chairman of the Board. Some of our major shareholders viz. Sabre Capital, Bank Muscat and Keppel Corporation, Singapore are represented on the Board.

Recent trends in global business

Exports of India are broadly classified into four categories: i) Agriculture and allied products which include coffee, tea, oil, cakes, tobacco, cashew kernels, spices, sugar, raw cotton, rice, fish and fish preparations, meat and meat preparations, vegetable oils, fruits, vegetables and pulses; ii) Ores and minerals include manganese ore, mica and iron ore; iii) Manufactured goods include textiles and ready-made garments, jute manufactures, leather and footwear, handicrafts including pearls and precious stones, chemicals, engineering goods and iron steel; and iv) mineral fuels and lubricants.

There were many reasons why our export effort did match our import requirements:

i. The major export items of India were till recently agriculture based and the prices of primary goods generally remained low in the international commodity markets, mainly because the demand of developed countries for these goods was inelastic and partly due to the failure primary goods producing countries acting together.

ii. The ever-increasing domestic consumption and inadequate export surplus in certain commodities, e.g., sugar, vegetables, meat, etc. The demand for which has been rising;

iii. Export promotion measures, such as tax and other incentives were found inadequate, particularly in the context of larger incentives provided even by advanced countries like Germany and Japan;

iv. The policy of protectionism adopted by advanced countries such as U.S.A preventing the full flow of exports from developing countries,

v. Long period of business recession in recent years in most developed countries, resulting in sluggish international demand; and

vi. The unit value of exports has risen much more that the quantum index of exports, shoeing that the increase in the value of exports was partly monetary. But then, the rise in the unit value of imports was much grater then the unit value of exports.

The structure of Indian exports is typical of a developing economy. India has traditionally been an exporter of agricultural raw materials ad allied products. One reason for the relative decline of food, beverages and tobacco in the total exports is the increase in population and consequent increase in

domestic consumption of these goods. Accordingly, the export surplus in many traditional commodities like tea has not been increasing as much as the Government would have wished. In this connection, the growing importance of certain products in this category should be noted, i.e., fish and fish products, cashew kernels, coffee and rice. Vegetables and fruits are also growing in importance.

Since 1960, under the impact of industrialization, exports of non-traditional items are gaining in importance. These items consist of engineering goods, handicrafts, which include pearls, precious and semi precious stones and jewellery, iron and steel, iron-ore, chemicals, readymade garments, fish and fish preparations. These goods constitute more than 6 percent of India's exports now. The fact that some of these non-traditional items - such as engineering goods, handicrafts, ready-mades, etc.-have established themselves in the markets of even the most advanced countries show tat they would continue to be part of India's exports in the year to come.

The sharp increase in the export of electronic goods and software is really welcome development. The trend needs to be strengthened further.

However, the export of some items is quite disturbing for the country - for instance the export of iron ore and specially iron and steel show the inability of the economy to use basic development goods. On the other hand, the import of iron and steel is much more significant, showing the under utilization of steel capacity created in the country. Thus, the increasing contribution of non traditional items in India's export has been commendable bit not consistent enough.

We should not however, conclude that only non-traditional items are to the fore and the traditional items have suffered a retreat. Exports of traditional items are also expanding, though probably not to the extent desired. Examples are the respectable growth in cotton fabrics, tea, leather and leather manufactures etc.

Thus the pattern of India's exports indicates that (a) the Indian economy is being diversified and (b) non-traditional items of exports are growing in importance.

b) The large expansion of engineering goods is partly the result of pick-up in demand in industrial countries and also from the Middle East countries which have undertaken infra-structural projects like roads, ports and rail construction, telecommunication and civil construction.

c) India is now in position to take advantage of both favourable demand situation and attractive price situation in international markets.

d) While some commodities have tremendous exports potential (e.g. handicrafts, engineering goods and ready-mades), others (like sugar, jute, yarn and manufactures, iron and steel) have fluctuated widely.

e) With the announcement of the new agricultural policy, emphasis is being given to boosting the export of agricultural produce. Rice export is gaining importance. Besides this, fruits and vegetables and processed foods are also becoming significant in our exports.

Functions of commercial Banks and global business.

The following are the modern functions of commercial banks.

Global business is developed with the help of modern functions of commercial banks.

1. Teller system
2. ATM system
3. Home banking
4. Green card
5. Factoring
6. Mutual funds
7. Electronic clearing system
8. Gold or platinum card
9. Gold banking
10. e-Banking

1. Teller system: Under this system, when a customer presents a cheque, a counter clerk will make payment immediately. In big metropolitan cities, the bank provides this facility to the customers, so that they need not wait for a long time for withdrawal of money. The counter clerk will have the specimen signature of the customer and updated account card by hid side. As soon as a customer presents a cheque, the banker will be able to make payment immediately. This kind of system is called teller system.

2. ATM - Automatic Teller Machine: Under this system, a customer can withdraw money by using his credit card. The customer who wants to avail ATM facility will be given a code number, which will be kept secret by the customer. On the basis of credit limit, a customer is allowed to draw money from the ATM upto 40% of his credit. When a customer, wants to withdraw money through the ATM, first he has to insert the credit card into the machine. On the computer will have to give the PIN (Personal intelligent number), by pressing the key board of the computer. Then on the screen the amount to be withdrawn will be asked. The customer again uses the machine for informing

the amount required. Immediately, currency notes according to his requirements will flow through the machine. Along with this a small chit containing his account number, the amount withdrawn and his balance credit amount available will come out in the form of a print out. Thus, a customer without entering the bank premises can withdraw money even during non-banking hours. As this system does not involve the signature of the customer, it is important for the customer to keep his credit card and the PIN safely. Or else anybody who comes to know of the PIN and who gets hold of the credit card can withdraw money without the knowledge of the customer.

The ATM facility is available in all Metropolitan cities and a customer can withdraw money in any ATM anywhere in the country.

3. Home Banking: Instead of going to the bank for withdrawal of money or for depositing of cheques, a customer can do his banking business by sitting at home. For this purpose, the personal computer of the customer will be connected with the bank's computer through a network. The customer will have a secret code for operating his account from home. He will instruct the bank for different payments. Similarly, he will also receive credit from his debtors. Thus, in course of time home banking will minimize the use of documents. In fact, even the negotiable instruments' usage will be minimized. With the development of LAPTOP computer, the customer can even operate his bank account even while traveling by air.

4. Green card: In India, credit card facility is given to the farmers by issue of Green card to them. This will enable them to buy all their inputs by using the Green card. They can buy seeds, fertilizers and pesticides through this card. Thus, the bank is providing credit to the farmers by this Green card.

5. Factoring: Commercial banks in India are undertaking factoring business. Under this, the bills drawn by customers on the buyer will be handed over to the bank for collection. The bank will pay 80% of the value of the bill to the customer and the balance 20% will be paid after realizing the bill from the buyer. For this purpose, the bank will be paid factoring commission. SBI and Canara Bank were two banks which initially started factoring business. Other banks are now undertaking factoring business.

6. Mutual funds: To enable the customers to avail the benefit of investments, banks in India have started mutual funds. The savings of the customers are invested in mutual funds by purchase of units. The bank, after mobilizing the funds, invest the same in various company securities. Every day, the bank will give the value of the units in the form of Net Present Value, which is calculated by the total value of investments divided by the total

number of units. This NPV may change according to the fluctuations in the market value. It is the endeavor of every bank to maintain a higher NPV.

7. Electronic Clearing System (ECS): The telephone charges are being paid through this system. The banks are connected to the telephone department through a network by which, the telephone charges of the customers are paid. The customers will present their telephone bills to the bank which intimates electronically to the telephone department and the bills are paid by the bank. The use of computers in the payment of telephone bills is called ECS.

8. Gold or Platinum Card: Generally, customers are given credit card facility through the banks according to their credit worthiness. The purchase of the customers are restricted upto the available credit and once this limit is exhausted, the purchases through credit card will not be ratified and hence the customers will be denied the facility of purchase. But in the case of Gold or Platinum card, this credit limit restriction will not be there. Customers who are very rich, and who have a very high social status will be provided Gold or Platinum card. For this, purpose, the bank will have a detailed investigation of the person for whom the Gold or Platinum card is to be issued. A Gold or Platinum card holder can go to any part of the world for the purchase of valuable items through this card.

9. Gold Banking: It is a scheme introduced in 2000 - 2001 budget year by the Union finance minister and State Bank of India is the first bank in India to introduce Gold Deposit Scheme.

Around 13,0000 tons of gold are estimated to be available in India. Out of 13,000 tons, SBI has initially received 4.54 tons from 3051 individuals. This gold deposit will be used for giving loan to Jewellery industry under Metal (Gold) Loan Scheme by which export of gold jewels will pick up. State Bank of India is setting up a separate subsidiary unit for the purpose of gold banking.

10. e-Banking: e-Banking refers to electronic banking, wherein the entire operations are done by the customer through his computer system by using a code, which maintains secrecy of transactions.

E-Banking

A. Meaning of e-banking:

e-Banks is the electronic bank that provides the financial service for the individual client by means of Internet.

B. Functions of e-bank

At present the personal e-bank system provides the following services:

1. **Inquiry about the information of account:** The client inquires about the details of his own account information such as the card's/account's

balance and the detailed historical records of the account and download the report list.

2. **Card accounts' transfer:** The client can achieve the fund transfer between his own cards and transfer the fund to another person's Credit Card in the same city.
3. **Bank-securities accounts transfer:** The client can achieve the fund transfer between his own bank savings accounts or his own Credit Card account and his own capital account in the securities company. Moreover, the client can inquire about the present balance at real time.
4. **The transaction of foreign exchange:** The client can trade the foreign exchange, cancel orders and inquire about the information of the transaction of foreign exchange according to the exchange rate given by our bank on net.
5. **The B2C disbursement on net:** The client can do the real-time transfer and get the feedback information about payment from our bank when the client does shopping in the appointed web-site.
6. **Client service:** The client can modify the login password, information of the Credit Card and the client information in e-bank on net.
7. **Account management:** The client can modify his own limits of right and state of the registered account in the personal e-bank, such as modifying his own login password, freezing or deleting some cards and so on.
8. **Reporting the loss of the account:** The client can report the loss in the local area (not nationwide) when the client's Credit Card or password is missing or stolen.

C. Types of e-banking

1. Deposits, withdrawals, inter-account transfers and payment of linked accounts at an ATM;
2. Buying and paying for goods and services using debit cards or smart cards without having to carry cash or a cheque book;
3. Using a telephone to perform direct banking - make a balance enquiry, inter-account transfers and pay linked accounts;
4. Using a computer to perform direct banking - make a balance enquiry, inter-account transfers and pay linked accounts.

D. Advantages of e-banking

The following are the important benefits of e-banking

1. **Account Information:** Real time balance information and summary of day's transaction.

2. **Fund Transfers:** Manage your Supply-Chain network, effectively by using our online fund transfer mechanism. We can effect fund transfer on a real time basis across the bank locations.
3. **Request:** Make a banking request online.
4. **Account Information:** The complete database that the bank has about out company is available to us at our terminal. It provides us:
   (i) Current balance in our account on real-time basis.
   (ii) Day's transactions in the account.
   (iii) Details of cash credit limit, drawing power, amount utilized, etc.
5. **Downloading of account statements as an excel or text file.** The statements can be integrated with your ERP system for auto-reconciliation.
6. **Fund Transfers:** Manage our Supply-Chain network, effectively by using our online fund transfer mechanism. We can effect fund transfer on a real time basis across the bank locations. The product facilitates:
   (a) **One-to-one fund transfer** between two linked account.
   (b) **Bulk fund transfers**: In bulk fund transfers, we upload a flat file containing payment/collection information. Our systems take care of processing the entire file and once the file is processes we can integrate the processed file to our ERP for auto reconciliation.
7. **The real life situation of user-wise limits and multilevel signatories** can be mapped in the net-based fund transfer module too. We can specify user-wise cap for funds transfer and the number of approvals needed for each fund transfer. The fund transfer will not take place unless the required number of signatories has approved it.
8. **With a Power of Attorney from our dealers, we can link the dealer's accounts** to our account in order to have an online fund transfer, saving us time and money involved with cheque collection systems. Alternatively, the dealer can credit our account through this channel. Similarly, we could also effect vendor and other payments online.
9. **Customers can also submit the following requests online:** Registration for account statements by e-mail either daily / weekly/ fortnightly/ monthly basis.
   (i) Stop payment of cheque
   (ii) Cheque book replenishment
   (iii) Demand Draft/ Pay-order
   (iv) Opening of fixed deposit account

(v) Opening of Letter of credit

10. **The company does not have to spend anything extra to avail such facilities.** All it requires is an Internet connectivity. The product enables the company to pro-actively manage its cash flows, ease reconciliation efforts as well as the MIS is available at the click of the mouse.

11. **Customer can Integrate the System with his Own ERP:** The customer can download the account statements either as a text file or as an excel file. The bank can help him in integrating the account statements and bulk payment files with hid ERP system. The Bank may charge a nominal fee depending upon the nature of work involve.

12. **Bill Payment through Electronic Banking:** Internet has thus ushered the concept of any time any anywhere banking. To the individual the onerous task of visiting several places to settle his service bills like telephone, water, electricity etc., can be overcome through the electronic Bill Pay service provided by the bank. He can pay his regular monthly bills (telephone, electricity, mobile phone, insurance, etc.) right from his desktop. No more missed deadlines, no more loss of interest. He can schedule his bills in advance, and thus avoid missing the bill deadlines as well as earn extra interest on his money.

13. **The Electronic Shopping Mall:** The customer can also make his shopping payment through the Bank's secure website-so that he can shop online any security worries, as the bank can provide online real time shopping mail services through partner shopping sites.

14. **Effecting Personal Investments through Electronic Banking:** The bank's website can also the customer to invest in shares, mutual funds and other financial products.

15. **Trading in Shares:**

(i) **Cash Trading.** This is a delivery based trading system, which is generally done with the intention of taking delivery of shares or monies.

(ii) **Margin Trading.** Customers can also do an intra-settlement trading normally up to 4 times his available funds, wherein he can take long buy/ short sell positions in stocks with the intention of squaring off the position within the same settlement cycle.

(iii) **Spot Trading.** When looking at an immediate liquidity option, 'Cash on Spot' may work the best for him. On selling shares through "cash on spot", money is credited to his bank a/c the same evening and not on the exchange payout data. This money can then be withdrawn form any of the Bank's ATMs.

(iv) The customer can also trade directly at the recognized stock exchanges of the country through his bank.

16. Investing in Mutual funds: Electronic banking also brings the customer the same convenience while investing in Mutual funds - Hassle free and Paperless Investing. He can invest in mutual funds without the hassles of filling application forms or any other paperwork. He needs to provide no signatures or proof of identify for investing. Once he places a request for investing in a particular fund, there are no manual processes involved. His bank funds are automatically debited or credited while simultaneously crediting or debiting his unit holdings.

17. Trade in Derivations: Trade in derivatives includes the following:

(i) Futures. Through electronic banking the customer can also trade in index and stock futures on the approved stock exchange. In futures trading, he takes buy / sell positions in index or stock(s) contracts having a longer contract period of up to 3 months.

(ii) Options. An option is a contract, which gives the buyer the right to buy or sell shares at a specific price, on or before a specific date. For this, the buyer has to pay to the seller some money, which is called premium. There is no obligation on the buyer to complete the transaction if the price is not favorable to him. To take the buy / sell position on index / stock options, he has to place certain percentage of order value as margin. With options trading, he can leverage on his trading limit by taking buy / sell positions much more than what he could have taken in cash segment.

18. Initial Public Offers Online: The customer could also invest in initial public offers online without going through the hassles of filling ANY application form / paperwork. Get in-depth analyses of new initial public offer issues, which are about to hit the market and analysis on these. Initial public offer calendar, recent initial public offer listings, prospectus / offer documents, and initial public offer analysis are few of the features, which help a customer to keep on the initial public offers markets.

There can be no end to the variety of services that can be provided through the electronic channel by banks and financial institutions. Every Institution is trying constantly to innovate and offer new products to woo the customer. The benefit to the customer on account of the Internet is that he is able to know at a time the types of facilities being provided by different Institutions and he is able to make the best choice suited for his needs.

The benefit to the employee is equally amazing. From being earlier a dumb worker filling up forms and copy from books, he is now a regular service provider and one who directly cares for the customer. Earlier he was dealing

with particular process, but today he handles customer's demands, which are functions for the bank / financial institution. In turn the knowledge resources required of him has grown and he is able to secure the same through better training and other organizational development programms like organizing work groups and functional teams, where persons with different skills and qualifications pool their knowledge and carry out high-tech services and operations.

19. Other benefits: The e-banking provides some other benefits also. They are:

(i) Convenience.

(ii) Speed of concluding transactions.

(iii) Speed - banking form own home.

(iv) Economy - banking without visiting your bank.

(v) Cheaper service fees.

(vi) Seamless Integration with existing environment (IDM - Intelligent Data Module).

(vii) Highly Scaleable.

(viii) Easy Customization

(ix) Lower Costs of both Installation and Maintenance.

(x) Platform Independence.

(xi) Round - the - Clock and Cross - Border Availability.

(xii) Remote Authorization.

E. Limitation of e-banking

1. Safely situations around ATMs.
2. Abuse of bank cards by fraudsters at ATMs.
3. Danger of giving your card number when buying on-line.

The modern technology has influenced the financial sector to a large extent. It increases the competitive efficiency of the firms and provides sophistication to the end users. It makes everyone fittest to survive.

Computerization of Bank Branches

The reforms in the 1990s, which led to expansion, consolidation and liberalization of the banking and financial sector in India, brought in many changes and challenges. A number of private and foreign players entered the Indian market with superior technologies that helped them service their customers efficiently through multiple channels such as ATMs and online banking. Indian banks on the other hand have been using IT more out of compulsion and primarily for transaction processing. They now need to adopt IT to reposition banks into the integrated financial services market.

The need for providing improved customer service, reducing transaction costs and increasing productivity, shall be the main drivers for Banking sector to adopt IT. These considerations are particularly important for public sector banks in India, who are facing immense competition form private and foreign banks. IT can help them move from the present scenario where they are working as isolated islands to providing a centralized banking experience. There is a need today for IT and the financial community to come together and develop customized IT solution to make the Indian Banking sector globally competitive.

IT adoption in the banking sector will provide real time availability of transaction processing through multiple channels. It would enhance a bank's ability to cross sell products, ensure better management and security and safety of funds and increase efficiency through integration of systems across various locations. It would also ensure efficient management of Non Performing Assets (NPAs), minimize transaction costs, enhance ability to conduct in-depth financial analysis and gather business intelligence. Enhanced use of IT would also encourage the use of Internet to provide access for online bill payments, funds transfers and e-statements in addition to encouraging wireless mobile banking and e-commerce.

With growing competition faced by foreign banks and financial institutions, the public sector banks in co-operation with the Indian IT industry would need to equip themselves for the next phase of introducing the benefits of IT to their customers by providing a centralized banking solution.

Opportunity for Indian Banking sector in branch computerization

1. IT Networking
2. System Integration and Management
3. Customer Relationship Management (CRM) Applications
4. Back Office Processing and Call Centres
5. Data warehousing / Data mining

6. Mobile and e-banking.

Computerization of Banks In India

E-commerce and e-banking are the buzz words in the global commercial activities today. E-banking or Electronic banking refers to conducting activities with the help of information technology (IT) and computers.

Computerization of banking functions in India was resisted by labour unions for fear of loss of job opportunities. Secondly, computerization needs IT savvy personnel which require intensive technical training. Thirdly, computerization needs heavy capital outlay for purchases of machines. Fourthly, to have effective computerization of banks a large number of bank branches situated in rural areas need to be connected. Telecommunication facility at rural areas is slow to reach. For the reasons mentioned above, computerization made a slow entry in Indian banks.

Credit card

Credit card originated in the Unite States during 1920s when individual companies such as hotel chains and oil companies began issuing them to customers for purchase made at their business unit. The use increased after Second World War. Diners Club introduced the first universal credit card that can be used at a variety of stores businesses. In 1958, the American Express company established another universal card called 'Don't leave home without it'. It is only after such developments, bank credit came into existence

What is credit card?

A credit card is given by the banker to the customer in which the name of the customer is embossed in block letters. The name of the bank and the date of issue and expiry are also mentioned on the face of the card. The reverse side of the card will bear the specimen signature of the customer. A list of vendors or sellers will be given by the banker to the customers.

A credit card is a thin plastic card, usually 3 1/8inches × 2 1/8 inches in size that contains identification information such as signature or picture or both and authorize the person named on it to charge for purchase or services to his account. In addition to this, the card can be used in automated teller machines (ATM) for withdrawing cash an the machine stores the information and also transactions through electronic date processing system.

Working of credit Card System

The customers can use the credit card for purchasing goods and availing services from the various shopkeepers. When the customer makes a purchase in a shop, instead of making payment, he/she produces the card at the cash counter. The seller examines validity of the card through a machine, which

ratifies the sale. The bill is made in there copies. The customer is given the bill in which his/her signature is obtained. The sale becomes complete. A copy of the bill on which is given to the third copy is retained by the seller. The bank, on receiving various such bills of the customers, will prepare consolidated bill and send it to the customer at the end of the month. The customer will make a single payment to the bank or allow the bank to debit his/her account. In every bill, the due date of payment will be given. If a customer fails to pay within the due date, interests will be added on the purchase. It is also not necessary that the customer should pay full payment of the bill as he/she can make part payment and settle the bill in due course. However, the customer will have to pay interest for the balance amount outstanding. If payment is made for all the purchases, the customer is allowed to avail fresh credit.

Credit limit: A credit limit is fixed based upon the income of the customer. The customer can make purchase only upto credit limit fixed by the card issuer. Once payment is made by the customer, the credit limit will once again revolve to the original amount.

The sellers can avail the facility of sale through credit card by paying to the credit card establishment, a fixed amount. The sellers agree to this, as the use of credit cards by customers enhances their sale. On receipt of payment from customers the sellers account will be credited.

Types of Cards:

There are different types of cards available.

1. Change card
2. Debit card
3. Deferred Debit card
4. Affinity card
5. Standard card
6. Classic card
7. Gold card
8. Platinum card
9. Best platinum card
10. Fleet platinum credit card
11. Next card platinum card
12. Titanium card
13. Secured card
14. Smart card

Change card: In this card, the cardholder has to make full payment of the charge by the due date. Unlike other credit cards, here dues are not allowed to carry forward. It is meant for people who spend responsibly.

Debit card: A debit card is different from credit card. Debit card is issued by a bank.

The following are the differences between credit and debit cards.

1. A credit card is issued by an agency such as Master or Visa.	1. A debit card is issued by a bank in which the card opener has his account
2. A credit card allows certain period for making payment for the purchase made which may vary from 30 to 45	2. The bank account in a debit is debited immediately the moment the card is used. So, there is no credit period.
3. The credit worthiness of the customer is based on income eligibility criteria on the basis of which the credit card is issued	3. There is no such income criteria but the *credit balance,* maintained in the account is the criterion.
4 A credit card holder has a ceiling limit for his purchases and also for his cash withdrawals through ATM	4. A debit card holder has his purchases restricted to his credit balance.
5. Credit card can be used for withdrawing money only from ATMS	5. A debit car can be used even for with drawing money form the bank mobile ATM
6. When the purchase are made by using the credit card, the retail seller swipes the card, the retail seller swipes the card over an electronic terminal at his outlet, and enters the personal identification number (PIN) and the transactions are recorded by the card issuing	6. Any use of debit card by a similar method will be immediately recorded by the bank and the account of the customer is debited. Thus, it is an online transaction.
7.Loss of credit card should be reported to the issuing agency	7. Loss of debit card should be reported to the issuing bank

Deferred debit card: When a debit card carries the benefit of the credit card, allowing the payment after certain period, it is called deferred debit card.

Affinity card: A card offered by two organizations of which one is a lending institution and the other a non financial group. Here, schools, non profit groups, airlines, petroleum companies issue affinity cards. These cards carry special discounts.

Standard card: It is a normal credit card which carries limit on transactions, according to the credit worthiness of the card holder.

Classic card: A credit card issued by Visa, carrying the logo of Visa.

Gold card: A higher line of credit is given than a standard card. The income eligibility for getting this card is higher. Gold card is given to very rich customers or persons with high social status.

Platinum card: In order to distinguish credit cards belonging to certain companies, platinum credit cards are issued. Some companies use these to denote their best premium credit card.

Best Platinum credit card: Companies which set highest standard in customer service issue these cards. There is lowest interest rate for the out standings, and the cards will have no annual fee or application fee and can be applied online in seconds.

Fleet Platinum credit card: It is zero liability guarantee for purchases. It protect the credit card holder from any unauthorized use.

Next card platinum credit card: This is given to those with a good credit and it offers a low introductory rate.

Titanium card: A card which has a higher credit limit than a platinum card.

Secured card: A credit card is given to a card holder who has saving deposit which will take care of his outstanding balance, in case of his default on payment.

Smart card: The revolution in information technology is responsible for the invention of smart card.

BACHELOR OF BUSINESS ADMINISTRATION
SECOND YEAR
MODEL QUESTION PAPER -1
ALLIED – II : ECONOMICS AND GLOBAL BUSINESS

Time : 3 Hours Maximum :100 Marks

Part A (10 × 2 = 20 Marks)

(Answer to each question shall not exceed six lines)

1. Define business economics.
2. Explain social responsibilities of business.
3. Define demand.
4. What is business Cycle?
5. What is monopoly?
6. Duopoly means what ?
7. GATT means what?
8. WTO - Explain.
9. UTI - Explain.
10. What is IDBI?

Part B (5 × 4 = 20 Marks)

(Answer to each question shall not exceed two pages)

11. (a) What are the conditions for profit maximization?

    (Or)

    (b) Explain the arguments in favour of social responsibilities of business.

12. (a) What are the determinants of demand?

    (or)

    (b) Explain - Price elasticity of demand.

13. (a) Explain price discriminations.

    (or)

    (b) What are the characteristic of oligopoly?

14. (a) What are the functions of WTO?

    (or)

    (b) Explain the achievements of GATT.

15. (a) What are the functions of IDBI?

(or)

(b) What is the role of private bonus?

Part C (5 × 12 = 60 marks)

(Answer All Questions Answer to each question shall not exceed five pages)

16. (a) Explain the nature and scope of business economics.

(or)

(b) Explain arguments against the social responsibilities of business.

17. (a) What is cross elasticity of demand?

(or)

(b) Discuss four phases of trade cycle.

18. (a) What are the objectives of pricing?

(or)

(b) Explain - winked demand curve.

19. (a) Explain the importance of foreign capital.

(or)

(b) Explain the role of India in globalisation.

20. (a) What are the uses of ATM?

(or)

(b) Explain the uses of credit cards.

BACHELOR OF BUSINESS ADMINISTRATION

SECOND YEAR

MODEL QUESTION PAPER -2

ALLIED – II : ECONOMICS AND GLOBAL BUSINESS

Time : 3 Hours   Maximum :100 Marks

Part A (10 × 2 = 20 Marks)

(Answer to each question shall not exceed six lines)

1. State Meaning of Business Economics.
2. Write few objectives of profit maximization.
3. Define Elasticity of Demand.
4. Write four phases of Business cycle.
5. State features of perfect competitions.
6. What is Duopoly?
7. Expand GATT, WTO
8. What is LPG?
9. Write two function of ICICI
10. State a few business achievements of IndusInd Bank.

Part B (5 × 4 = 20 Marks)

(Answer to each question shall not exceed two pages)

11. (a) Explain the nature and scope of Business Economics.

    (Or)

    (b) Explain about Social responsibilities of business.

12. (a) What is the significance of demand forecasting.

    (or)

    (b) Explain different kinds of Price Elasticity of Demand.

13. (a) Explain about Discriminating monopoly with examples.

    (or)

    (b) Differentiate oligopoly with Duopoly.

14. (a) Write a note on GATT

    (or)

    (b) Explain about Economic Liberalization.

15. (a) Explain about Tele-banking

(or)

(b) Differentiate Debit Card with Credit Card

Part C (5 × 12 = 60 marks)

(Answer All Questions Answer to each question shall not exceed five pages)

16. (a) Explain various objectives of profit maximisation.

(or)

(b) Explain about arguments for and against the social responsibilities of business.

17. (a) Illustrate with an example the Law of demand with a suitable schedule and diagram

(or)

(b) Discuss about Business cycles.

18. (a) Explain about price determination under perfect competition

(or)

(b) Briefly explain price determination under monopoly with suitable diagrams.

19. (a) Explain about Global Business Environment.

(or)

(b) Explain about GATT and WTO

20. (a) State role of private banks in Indian Economic development

(or)

(b) Explain about different types of cards.

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