



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY & GTU)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2- Vaishalinagar  
Nr. Amrapali Railway  
Raiya Road, Rajkot – 360001  
Ph.No–(0281)2440478, 2472590

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**Raiya Road, Rajkot – 360001**  
**Ph. No–(0281)2471645**

**2- Vaishalinagar**  
**Nr. Amrapali Railway**  
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**Ph.No–(0281)2440478, 2472590**

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2- Vaishalinagar  
Nr. Amrapali Railway  
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## B.B.A. SEM -3

# Managerial Economics

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2- Vaishalinagar  
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## UNIT 1 INTRODUCTION TO MANAGERIAL ECONOMICS & DEMAND FORECASTING

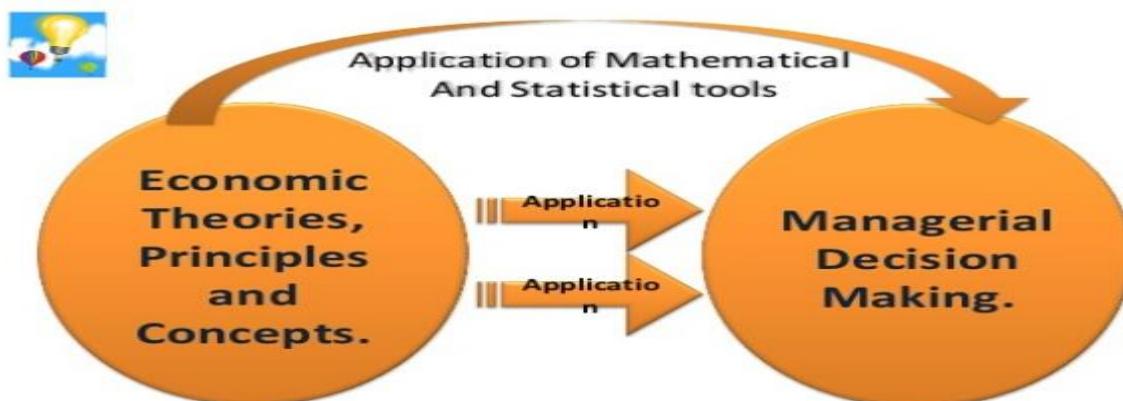
### MEANING

In the words of Mr. Nair and Meriam, “Managerial Economics consists of the use of economic modes of thought to analyze business situations.”

Managerial economics generally refers to the integration of economic theory with business practice. Economics provides tools managerial economics apply these tools to the management of business. In simple terms, managerial economics means the application of economic theory to the problem of management. Managerial economics may be viewed as economics applied to problem solving at the level of the firm.

It enables the business executive to assume and analyze things. Every firm tries to get satisfactory profit even though economics emphasizes maximizing of profit. Hence, it becomes necessary to redesign economic ideas to the practical world. This function is being done by managerial economics.

## Managerial Economics



### Nature/ Characteristics of Managerial Economics





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## 1) It is a Science

Managerial Economics is a branch of economics. Economics is a science and so do the managerial economics. Cause and effect relationship is studied by managerial economics. For example, a change in the price of commodity is a cause and effect on various other factors is studied. It helps in formulating right policies, plans and helps in analysing the right situation.

## 2) Managerial Economics is an art

. Managerial Economics is an art. Art is a systematic knowledge helpful in doing and representing things in best possible manner for attaining specific objectives. Due to this reason, the management tackles same problem effectively in different way in order to achieve desired Outcome.

## 3) It is a normative science

Managerial economics is a science of normative type. It always studies that what should be done and what ought to be. It always suggests that what should be done under a given situation. That is why it is not static.

## 4) It is pragmatic in nature

Managerial economics is pragmatic in nature. It helps in solving day to day problems arising in business enterprise. It takes into consideration difficult aspects of business

## 5. Managerial Economics for administration of organization

- Managerial economics helps the management in decision making. These decisions are based on the economic rationale and are valid in the existing economic environment.

## 6. Managerial economics is helpful in optimum resource allocation

- The resources are scarce with alternative uses. Managers need to use these limited resources optimally. Each resource has several uses. It is manager who decides with his knowledge of economics that which one is . use of the resource.

## 7. Managerial Economics has components of microeconomics



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- Managers study and manage the internal environment of the organization and work for the profitable and long-term functioning of the organization. This aspect refers to the microeconomics study. The managerial economics deals with the problems faced by the individual organization such as main objective of the organization, demand for its product, price and output determination of the organization, available substitute and complimentary goods, supply of inputs and raw material, target or prospective consumers of its products etc.

## 8. Managerial Economics is dynamic in nature

- Managerial Economics deals with human beings (i.e. human resource, consumers, producers etc.). The nature and attitude differs from person to person. Thus to cope up with dynamism and vitality managerial economics also changes itself over a period.

## 9. Theory of firm

Managerial economics make wide use of economic theories and concepts. Due to this reason, managerial economics is known as ‘Theory of Firm’ or ‘Economics of Firm’. Various economic concepts and theories are used to solve practical problems of business.

### Scope of Managerial Economics:



## 1. Demand analysis and forecasting

- When a business manager decides to venture into a business, the very first thing he needs to find out is the nature and amount of demand for the



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product, both at present and in the future. A firm's performance and profitability depends upon accurate estimates of demand. The firm will prepare its production schedule based on demand forecast. Demand analysis helps to identify the factors influencing the demand for a firm's product and thus helps a manager in business planning. Demand analysis and forecasting thus help him in the choice of the product and in planning output levels. The main topics covered under demand analysis and forecasting are the concepts of demand, demand determinants, law of demand, its assumptions, elasticity of demand (price, income and cross elasticity), demand forecasting, etc.

## **2. Cost and production analysis**

- Estimation of the cost in production.
- Recognizing the factors, which are causing cost to firm.
- Suggests cost should be reduced for making good profits.
- Production analysis deals with, Minimum cost should be spend on raw materials and maximum production should be obtained

## **3. Pricing decisions, policies and practices**

- Once a particular quantity of output is ready for sale, the firm has to fix its price given the conditions in the market. Pricing is a very important aspect of Managerial Economics as a firm's revenue earnings largely depend on its pricing policy. A correct pricing policy makes a firm successful, while incorrect pricing may lead to its elimination. The topics covered under this area are: price determination in various market forms such as perfect market, monopoly, oligopoly, etc., pricing methods such as differential pricing and product-line pricing, and price forecasting.

## **4. Profit management**

- Business firms are established with the objective of making profits and it is thus the chief measure of success. For maximizing profits the firm needs to take care of pricing, cost aspects and long-range decisions, i.e., it has to evaluate its investment decisions and carry out the best policy of capital budgeting for the firm under a given set of conditions. If we know the future, profit analysis would be an easy task. However, in a world of uncertainty our expectations are not always realized, so that profit planning and measurement constitute a difficult area of Managerial Economics. The important aspects covered under this area are: nature and measurement of



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profit, profit policies, and techniques of profit planning like break-even analysis, cost-volume-profit analysis, etc.

## 5. Capital Management:

- Still another most challenging problem for a modern business manager is of planning capital investment. Investments are made in the plant, machinery, and buildings, which are very high. Therefore, capital management requires top-level decisions. It means capital management i.e., planning and control of capital expenditure. It deals with Cost of capital, Rate of Return and Selection of projects.

## 6. Competition

- Study of markets is one of the important aspects of the work of a managerial economist. A manager should have clear knowledge of different markets existing in the environment. The environment is not constant and goes on changing. Thus, the manager should know clearly about perfect and imperfect markets so as to introduce the product in such markets where he can increase the sales revenue. The main aspects are perfect market, monopoly market, monopolistic market, oligopoly market, and price fixation under different market conditions

## IMPORTANCE OF MANAGERIAL ECONOMICS:

### 1. Useful in Business organization

- In any institution or firm. How should any production be done, and for whom should be produced? The answer to all these questions remains only with the managerial economy. Because he plays the most important role in these tasks.
- Therefore, we can say that managerial economics plays a very big role and significance in the important decisions of the business. Therefore, this is very good Role and Importance of Managerial Economics in Choosing Right Decisions of any business.

### 2. Helpful in Chalking Out Business Policies



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- The art is only in business economics to maximize the profit of any institution and minimize cost. In addition, whatever policies are made from this. It is very useful for any business or firm so that every firm and business can get the maximum benefit. Then we can say that there is a huge contribution of managerial economics in profit maximization and determining policies. It also helps in doing it.

### 3. Help in Business Planning

- Business economics is very useful in planning a complete prospect between the successful operation and production of any business or firm. Which acts as a balance bridge between the production tools and operating systems and where to go. Therefore, this is the biggest and important role of business economics in any business or firm.

### 4. Helpful in Cost Control

- Managerial economics decides the business is going towards profit or loss. Managerial economics decides which way is good for the business. In addition, it is only possible when managerial economics plays a very big and important role in the cost control decisions. Thus, Role and Importance of Managerial Economics in Choosing Right Decisions is very powerful.

### 5. Useful in Coordination of Business Activities

- The managerial economics is useful in coordinating the various activities of a business.

### 6. Useful in Demand forecasting

- The managerial economics provides useful tools for economics managers in demand forecasts and is useful in demanding production planning. The managerial economy deals with the future losses easily. So that any business can be protected against future losses.

### 7. Helpful in profit planning and control

- Managerial economics helps managers to decide on the planning and control of the benefits. Managerial Economics is synchronized between



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the planning and control of any institution or firm and hence its importance increases.

## 8. Helpful for Business Prediction

- It is not known to anyone about what is going on in business. Therefore, business economics tells us that the business can see what is troubling in the future. So Then the managerial economics gives its solutions. Therefore, that they can be avoided and the benefits can be increased.

## 9. Helpful in price determination

- Managerial Economics provides the necessary guidance in managing the pricing of its business. This proves this in order to raise the required data in pricing and get the maximum benefit. So That is the major role of managerial economics in the business decision critical. Without this, no business can progress

## DEMAND FORECASTING

Demand forecasting is a combination of two words; the first one is Demand and another forecasting. Demand means outside requirements of a product or service. In general, forecasting means making an estimation in the present for a future occurring event. Here we are going to discuss demand forecasting and its usefulness.

It is a technique for estimation of probable demand for a product or services in the future. It is based on the analysis of past demand for that product or service in the present market condition. Demand forecasting should be done on a scientific basis and facts and events related to forecasting should be considered.

Therefore, in simple words, we can say that after gathering information about various aspect of the market and demand based on the past, an attempt may be made to estimate future demand. This concept is called forecasting of demand.





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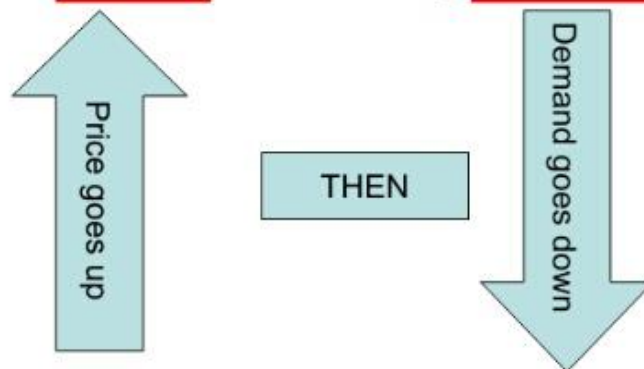
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## Law of Demand

Part 1. As **PRICE** increases, **DEMAND** decreases



Part 2. As **PRICE** decreases, **DEMAND** increases



### Objectives of Demand Forecasting

- Demand forecasting is one of the significant components in the success of any business. All organisational activities, whether they are short-term business operations or long-term strategic decisions, are dependent on it

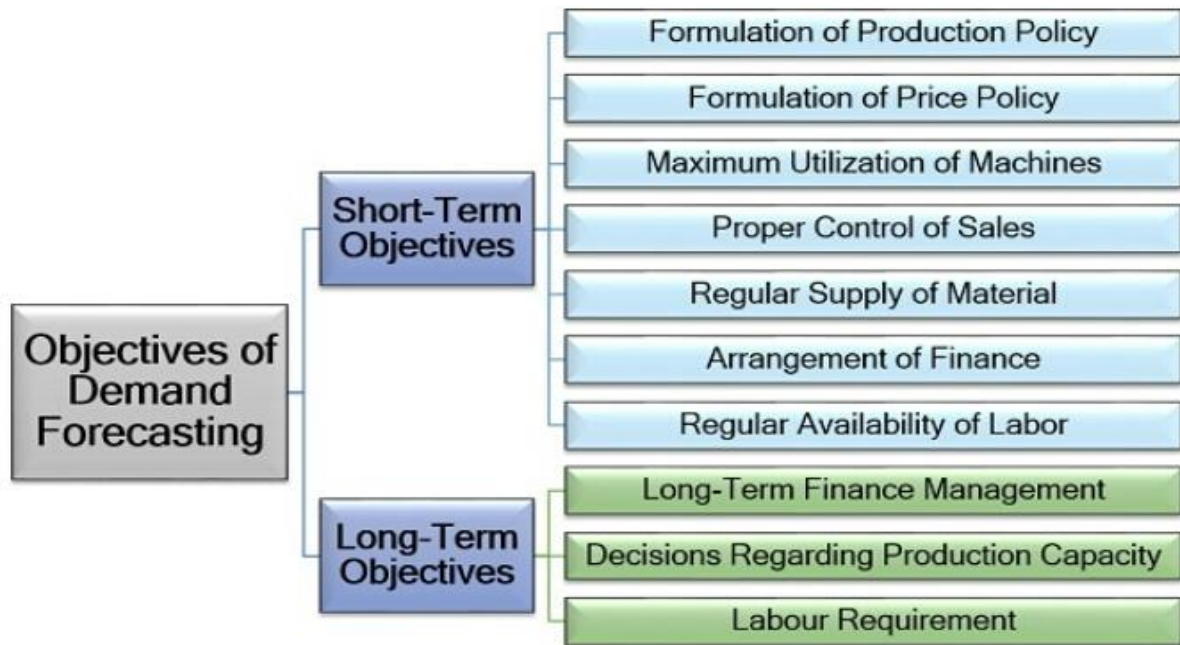


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**Short-Term Objectives:** To ensure the effective working of the organisation, estimation of sales for the past six months is done. Let us now go through the following purpose of demand forecasting in the short run:

### 1. Formulation of Production Policy:

Demand forecasting aims at meeting the demand by ensuring continuous production and supply of goods and services.

### 2. Formulation of Price Policy:

It helps in formulating an effective price mechanism to deal with the market fluctuations and conditions like inflation.

### 3. Maximum Utilization of Machines:

It streamlines the production process and operations such that there is the optimum utilisation of machines.

### 4. Proper Control of Sales:

Forecasting the sales of a particular product or service provides a base for setting a sales target and evaluating the performance.

### 5. Regular Supply of Material:





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Sales forecast determines the level of production, leading to the estimation of raw material. Thus, a continuous supply of raw material and inventory management can be done.

## 6. Arrangement of Finance:

To maintain short-term cash in the organisation it is essential to forecast the sales as well as liquidity requirement accordingly.

## 7. Regular Availability of Labour:

Estimation of the production capacity provides for the acquisition of suitable skilled and unskilled labour.

## Long-Term Objectives:

Demand forecasting is inevitable for the long-term existence of an organisation. Following objectives justify the statement:

### 1. Long-Term Finance Management:

Forecasting sales for the long-term contributes to long-term financial planning and acquisition of funds at reasonable rates and suitable terms and conditions

### 2. Decisions Regarding Production Capacity:

Demand forecast determines the production level, which provides a base for decisions related to the expansion of the production unit or size of the plant.

### 3. Labour Requirement:

Demand forecasting initiates the expansion of business, thus leading to the estimation of required human resource to accomplish business goals and objectives.

Estimating demand with accuracy requires a lot of expertise and knowledge.

Therefore, experts are hired by the business organizations to ensure better results and proper utilization of resources.

## Factors Affecting Demand Forecasting



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- Demand is never constant and fluctuates with the change in certain factors related to the commodity and the market in which the business operates. With the changing demand, it is forecasting also varies.
- Following are some of the factors which influence the demand forecasting of a commodity:



## 1. Price of Goods:

Demand estimation is highly dependent on the price of goods or services. The pricing policy and fluctuation in the present price can give an idea of change in demand for that particular commodity.

## 2. Type of Goods:

The kind of commodity, its features and usability determines the customer base it is going to cater. The demand for existing goods can be easily estimated by following the previous sales trend, competitors' analysis and substitutes available. Whereas, the demand for a new product on the market is difficult to predict.

## 3. Competition:

The level of competition in the market supports the process of demand forecasting. It is easy to predict sales in a less competitive market, whereas the same becomes difficult in a market where the new firms can freely enter.



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#### 4. Technology:

The demand for any product or service changes drastically with the advancement in technology. Therefore, it is essential for an organisation to be aware of technological development while forecasting the demand for any commodity.

#### 5. Economic Perspective:

Being updated with economic changes and growth is necessary for demand forecasting. It assists the organisation in preparing for future possibilities and analysing the impact of economic development on sales.

### IMPORTANCE OF DEMAND FORECASTING

#### 1. Distribution of resources:

We know that inputs are processed to result into output. These inputs include resources like materials, machinery and of course human resources. The business firm also has to take decisions regarding capital arrangement, labor planning and so on. These all could be done with a bit of ease if the firm has idea about the demand for its product. In short, the estimation of demand enables the firm to undertake critical business decisions.

#### 2. Helps in avoiding wastages of resources:

Demand forecasting is not an option but compulsion in today's competitive environment. Imagine a firm that does not undertake demand forecasting. As a result it will have no clue as to where its product stands in the market and how is the future demand for the same. This may result in wastage of resources. So in order to avoid wastages it is always beneficial to have a sense of future demand for the products and services.

#### 3. Serves as a direction to production:

The production process is not confirmed to producing goods and services. Producers need to ensure that there is continuous supply of goods and services in the market. If there is proper prediction of the demand, then it serves as a handy tool for the businesses to undertake future production activities. This is but obvious because if there is strong demand expected in the future then the firm can take steps accordingly. Also if the firm sees



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lack of demand in the coming times, then too decisions regarding the future production could be taken accordingly.

4. **Pricing:** The decision regarding pricing of the goods and services is perhaps one of the most critical business decisions. Demand forecasting is useful in this area too. If there are sincere predictions about the future sales of the firm's product then it could serve as a good aid to devise pricing strategies.
5. **Helps in devising sales policy:** Production is followed by sales. Demand forecasting is nothing but estimating the sales of the product. The business firms can plan its sales policy effectively on the backdrop of demand forecasting. This also implies that the distribution of goods and services can be done appropriately depending upon the predictions of the demand for the product.
6. **Decrease of business risk:** Where there is business there is risk. Demand forecasting though does not completely remove the business uncertainties, helps in reducing the risks and uncertainties to a certain extent.
7. **Inventory management:** Inventories is one of those aspects, which is closely associated with demand. This is because the producers to meet the demand in the coming times keep inventories. Demand forecasting helps in devising appropriate inventory management policies

Thus, we have seen that whether it is distribution of resources, production, sales or inventory, demand forecasting is useful in all these areas. The markets are nothing but a play of demand and supply. Since demand is such an indispensable part of the market, demand forecasting is bound to be of great help to the producers.

## Limitations of Demand Forecasting:

### 1. Just Estimates

The future will always be uncertain. Even if use the best of forecasting techniques and account for every aspect imaginable, a forecast is still just an estimate. One can never predict future events with 100% success. So



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even the best-laid plans may amount to nothing. This will always remain one of the biggest limitations of forecasting

## 2. Based on Assumptions

The basis of any forecasting method is assumptions, approximations, normal conditions, etc. This makes these forecasts unreliable. So one must always keep in mind the inherent limitations of forecasting and be cautious in being over-reliant on them.

## 3. Time and Cost Factors

The data and information required to make formal forecasts are generally a lot. In addition, the collection and tabulation of such data involve a lot of time and money. The conversion of qualitative data into quantitative data is also another factor. One must be careful that the time, money and effort spent forecasting must not outweigh the actual benefits from such forecasts.

### **Techniques or Methods of Demand Forecasting:**

Demand forecasting is a difficult exercise. Making estimates for future under the changing conditions is a Herculean task. Consumers' behavior is the most unpredictable one because it is motivated and influenced by a multiplicity of forces. There is no easy method or a simple formula, which enables the manager to predict the future. Economists and statisticians have developed several methods of demand forecasting.

Each of these methods has its relative advantages and disadvantages. Selection of the right method is essential to make demand forecasting accurate. In demand forecasting, a judicious combination of statistical skill and rational judgment is needed.

Mathematical and statistical techniques are essential in classifying relationships and providing techniques of analysis, but they are in no way an alternative for sound judgment. Sound judgment is a prime requisite for good forecast.

The judgment should be based upon facts and the personal bias of the forecaster should not prevail upon the facts. Therefore, amid way should be followed



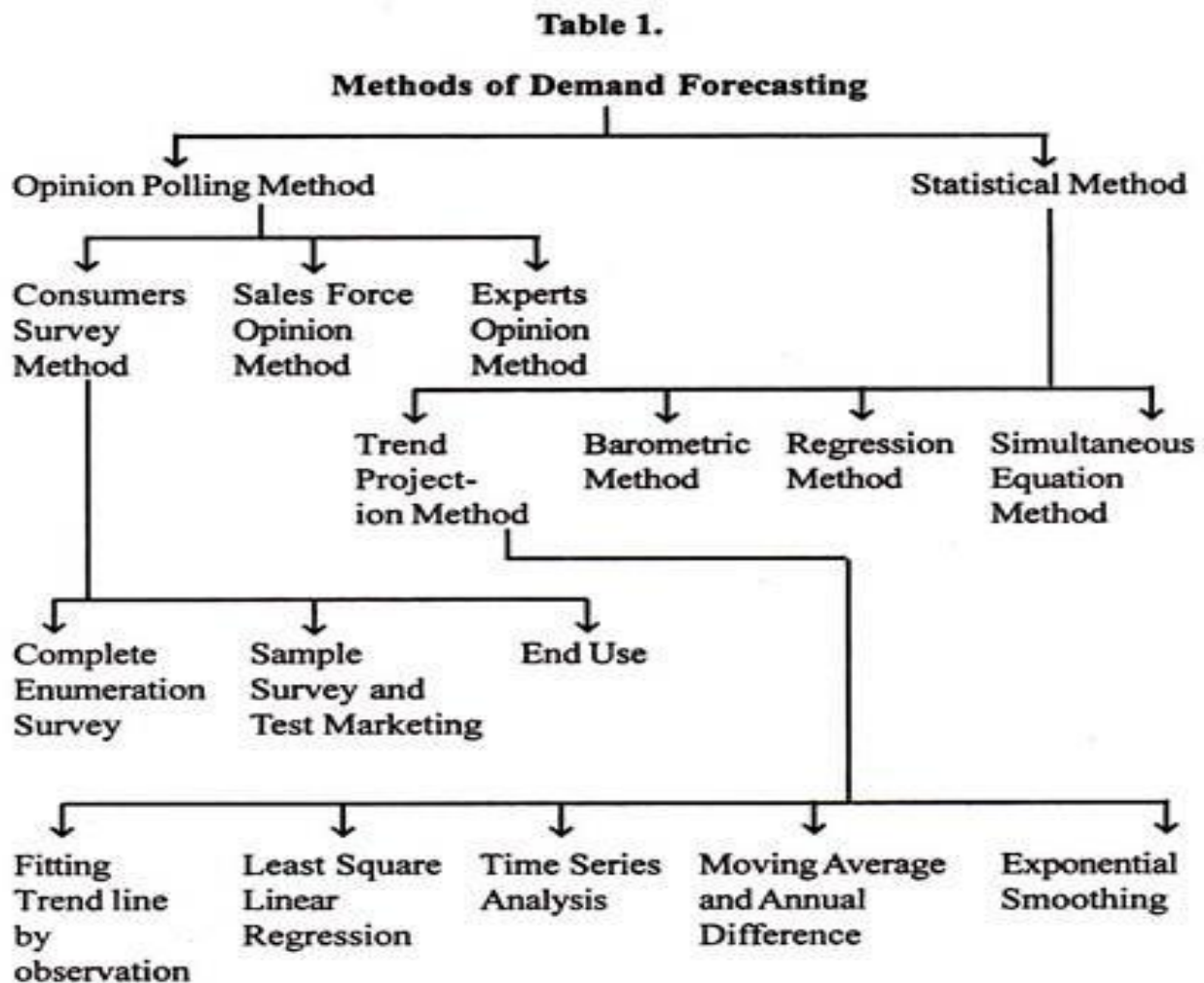
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between mathematical techniques and sound judgment or pure guesswork. The more commonly used methods of demand forecasting are discussed below.



## 1. Opinion Polling Method:

In this method, the opinion of the buyers, sales force and experts could be gathered to determine the emerging trend in the market.

**The opinion polling methods of demand forecasting are of three kinds:**

### (a) Consumer's Survey Method or Survey of Buyer's Intentions:

In this method, the consumers are directly approached to disclose their future purchase plans. This is done by interviewing all consumers or a selected group of





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consumers out of the relevant population. This is the direct method of estimating demand in the short run.

Here the burden of forecasting is shifted to the buyer. The firm may go in for complete enumeration or for sample surveys. If the commodity under consideration is an intermediate product then the industries using it as a product are surveyed.

### **(i) Complete Enumeration Survey:**

Under the Complete Enumeration Survey, the firm has to go for a door-to-door survey for the forecast period by contacting all the households in the area. This method has an advantage of first hand, unbiased information, yet it has its share of disadvantages also.

The major limitation of this method is that it requires lot of resources, work force and time. In this method, consumers may be reluctant to reveal their purchase plans due to personal privacy or commercial secrecy. Moreover, at times the consumers may not express their opinion properly or may deliberately misguide the investigators.

### **(ii) Sample Survey and Test Marketing:**

Under this method, some representative households are selected on random basis as samples and their opinion is taken as the generalized opinion. This method is based on the basic assumption that the sample truly represents the population. If the sample is the true representative, there is likely to be no significant difference in the results obtained by the survey. Apart from that, this method is less tedious and less costly.

A variant of sample survey technique is test marketing. Product testing essentially involves placing the product with a number of users for a set period. Their reactions to the product are noted after a period and an estimate of likely demand is made from the result.

These are suitable for new products or for radically modified old products for which no prior data exists. It is a more scientific method of estimating likely



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demand because it stimulates a national launch in a closely defined geographical area.

### **(iii) End Use Method or Input-Output Method:**

This method is quite useful for industries, which are mainly producer's goods. In this method, the sale of the product under consideration is projected as the basis of demand survey of the industries using this product as an intermediate product, that is, the demand for the final product is the end use demand of the intermediate product used in the production of this final product.

The end use demand estimation of an intermediate product may involve many final good industries using this product at home and abroad. It helps us to understand inter-industry relations. In input-output accounting, two matrices used are the transaction matrix and the input co-efficient matrix. The major efforts required by this type are not in its operation but in the collection and presentation of data.

### **(b) Sales Force Opinion Method:**

This is also known as collective opinion method. In this method, instead of consumers, the opinion of the salespersons is sought. It is sometimes referred as the "grass roots approach" as it is a bottom-up method that requires each sales person in the company to make an individual forecast for his or her particular sales territory.

These individual forecasts are discussed and agreed with the sales manager. The composite of all forecasts then constitutes the sales forecast for the organization. The advantages of this method are that it is easy and cheap. It does not involve any elaborate statistical treatment. The main merit of this method lies in the collective wisdom of sales representatives. This method is more useful in forecasting sales of new products.

### **(c) Experts Opinion Method:**

This method is also known as "Delphi Technique" of investigation. The Delphi method requires a panel of experts, who are interrogated through a sequence of questionnaires in which the responses to one questionnaire are used to produce





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the next questionnaire. Thus, any information available to some experts and not to others is passed on, enabling all the experts to have access to all the information for forecasting.

The method is used for long term forecasting to estimate potential sales for new products. This method presumes two conditions: Firstly, the panelists must be rich in their expertise, possess wide range of knowledge and experience. Secondly, its conductors are objective in their job. This method has some exclusive advantages of saving time and other resources.

## 2. Statistical Method:

Statistical methods have proved to be immensely useful in demand forecasting. In order to maintain objectivity, that is, by consideration of all implications and viewing the problem from an external point of view, the statistical methods are used.

### The important statistical methods are:

#### (i) Trend Projection Method:

A firm existing for a long time will have its own data regarding sales for past years. Such data when arranged chronologically yield what is referred to as 'time series'. Time series shows the past sales with effective demand for a particular product under normal conditions.

Such data can be given in a tabular or graphic form for further analysis. This is the most popular method among business firms, partly because it is simple and inexpensive and partly because time series data often exhibit a persistent growth trend.

Time series has four types of components namely, Secular Trend (T), Secular Variation (S), Cyclical Element (C), and an Irregular or Random Variation (I). These elements are expressed by the equation  $O = TSCI$ . Secular trend refers to the long run changes that occur because of general tendency.

Seasonal variations refer to changes in the short run weather pattern or social habits. Cyclical variations refer to the changes that occur in industry during



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depression and boom. Random variation refers to the factors, which are generally able such as wars, strikes, flood, and famine and so on.

When a forecast is made, the seasonal, cyclical and random variations are removed from the observed data. Thus, only the secular trend is left. This trend is then projected. Trend projection fits a trend line to a mathematical equation.

**The trend can be estimated by using any one of the following methods:**

(a) The Graphical Method, and

(b) The Least Square Method.

### a) Graphical Method:

This is the simplest technique to determine the trend. All values of output or sale for different years are plotted on a graph and a smooth free hand curve is drawn passing through as many points as possible. The direction of this free hand curve—upward or downward— shows the trend. A simple illustration of this method is given in Table 2.

**Table 2 : Sales of Firm**

Year	Sales (Rs. Crore)
1995	40
1996	50
1997	44
1998	60
1999	54
2000	62

In Fig. 1, AB is the trend line, which has been drawn as free hand curve passing through the various points representing actual sale values.



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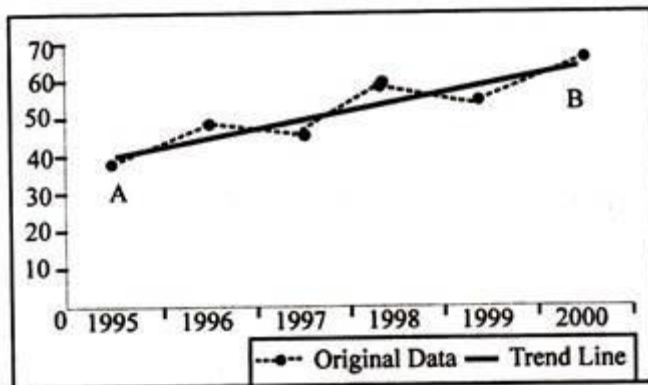


Fig. 1

## (b) Least Square Method:

Under the least square method, a trend line can be fitted to the time series data with the help of statistical techniques such as least square regression. When the trend in sales over time is given by straight line, the equation of this line is of the form:  $y = a + bx$ .

Where ‘a’ is the intercept and ‘b’ shows the impact of the independent variable. We have two variables—the independent variable  $x$  and the dependent variable  $y$ . The line of best fit establishes a kind of mathematical relationship between the two variables  $x$  and  $y$ . This is expressed by the regression  $y$  on  $x$ .

In order to solve the equation  $y = a + bx$ , we have to make use of the following normal equations:

$$\sum y = na + b \sum x$$

$$\sum xy = a \sum x + b \sum x^2$$

## (ii) Barometric Technique:

A barometer is an instrument of measuring change. This method is based on the notion that “the future can be predicted from certain happenings in the present.” In other words, barometric techniques are based on the idea that certain events of



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the present can be used to predict the directions of change in the future. This is accomplished by the use of economic and statistical indicators, which serve as barometers of economic change.

**Generally, forecasters correlate a firm's sales with three series:**

Leading Series, Coincident or Concurrent Series and Lagging Series.

**(a) The Leading Series:**

The leading series comprise those factors which move up or down before the recession or recovery starts. They tend to reflect future market changes. For example, baby powder sales can be forecasted by examining the birth rate pattern five years earlier, because there is a correlation between the baby powder sales and children of five years of age and since baby powder sales today are correlated with birth rate five years earlier, it is called lagged correlation. Thus we can say that births lead to baby soaps sales.

**(b) Coincident or Concurrent Series:**

The coincident or concurrent series are those which move up or down simultaneously with the level of the economy. They are used in confirming or refuting the validity of the leading indicator used a few months afterwards. Common examples of coinciding indicators are G.N.P itself, industrial production, trading and the retail sector.

**(c) The Lagging Series:**

The lagging series are those, which take place after some time lag with respect to the business cycle. Examples of lagging series are, labor cost per unit of the manufacturing output, loans outstanding, leading rate of short term loans, etc.

**(iii) Regression Analysis:**

It attempts to assess the relationship between at least two variables (one or more independent and one dependent), the purpose being to predict the value of the dependent variable from the specific value of the independent variable.



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The basis of this prediction generally is historical data. This method starts from the assumption that a basic relationship exists between two variables. An interactive statistical analysis computer package is used to formulate the mathematical relationship, which exists.

**For example, one may build up the sales model as:**

Quantum of Sales = a. price + b. advertising + c. price of the rival products + d. personal disposable income + u

Where a, b, c, d are the constants which show the effect of corresponding variables as sales. The constant u represents the effect of all the variables, which have been left out in the equation but having effect on sales. In the above equation, quantum of sales is the dependent variable and the variables on the right hand side of the equation are independent variables. If the expected values of the independent variables are substituted in the equation, the quantum of sales will then be forecasted.

**The regression equation can also be written in a multiplicative form as given below:**

Quantum of Sales = (Price)<sup>a</sup> + (Advertising)<sup>b</sup> + (Price of the rival products)<sup>c</sup> + (Personal disposable income)<sup>d</sup> + u

In the above case, the exponent of each variable indicates the elasticities of the corresponding variable. Stating the independent variables in terms of notation, the equation form is

$$QS = P^{0.8} \cdot A^{0.42} \cdot R^{0.83} \cdot Y^{0.83} \cdot 40$$

Then we can say that 1 per cent increase in price leads to 0.8 per cent change in quantum of sales and so on.

**If we take logarithmic form of the multiple equation, we can write the equation in an additive form as follows:**



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$$\log QS = a \log P + b \log A + c \log R + d \log Y_d + \log u$$

In the above equation, the coefficients a, b, c, and d represent the elasticities of variables P, A, R and  $Y_d$  respectively.

The co-efficient in the logarithmic regression equation are very useful in policy decision making by the management.

### **(iv) Econometric Models:**

Econometric models are an extension of the regression technique whereby a system of independent regression equation is solved. The requirements for satisfactory use of the econometric model in forecasting is under three heads: variables, equations and data.

The appropriate procedure in forecasting by econometric methods is model building. Econometrics attempts to express economic theories in mathematical terms in such a way that they can be verified by statistical methods and to measure the impact of one economic variable upon another to be able to predict future events.

## **UNIT:-2** **PRODUCTION FUNCTION**

### **Introduction:**

Production and consumption are the two important concepts used in managerial economics. A country's overall progress depends on these two terms. Production is the process, which leads to the various forces of an economy i.e. demand, supply, profit, loss; economic growth etc. Production function is an important part of managerial economics. The term production function denotes the functional relationship between the inputs used for the production process and the output. Every producer in modern times always considers production cost, demand and other many factor while taking decisions regarding production. The detail information in respect of production function and other related terms is as under.



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## Production Function

Production function reveals the relationship between input and output under the given technology. The concept of production function is summarized an explanation of technological possibilities.

Westbrook and Tybout has given the definition of production function in 1993 as under - “the relationship between input and output flows in manufacturing is determined by the technology employed and the economic behavior of the producer”. We can explain the concept of production with the help of following mathematical formula –

$$X = f(LKRSVY)$$

Here,

X = Output

f = Functional relationship

L = Labour

K = Capital

R = Raw material

S = Land

V = Returns to scale

## **Nature of Production Function:**

A production function is a flow concept. It relates to the flow of inputs and resulting flows of output of a commodity during a period of time. Thus the time element is an important attribute of a concept production function. We can classify this concept by the two types based on time element.

## **The Short-run Production Function:**

The short-run production function depicts the relationship of input factors to the output within a short-run period. In the short-run period, fixed factors of input cannot be changed. These types of production function includes fixed and variable components of inputs. When we change one input factor in the production function, the output results are of three types i.e. increasing returns, decreasing returns and lastly negatively returns. According to Paul Samuelson, “an increase in some inputs in a given state of technology, the cause output will be increase for some time and then it decreases.”





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We can explain this short production function with the help of following example.

Suppose land is a fixed factor and labour is a variable factor. We cannot increase the supply of land. When we change (increase) the quantity (number) of variable input (labour) in production process, at the initial stage the production increases, then it decreases and at last it becomes negatively. We can explain short run production function with the help of production schedule shown in the

**Table No. 4.1**

## Short-run Production Function

Fixed Factor (Land)	Variable Factor (Labour)	Total Production	Average Production	Marginal Production	Stages
5 Acre	1	5	5	5	Increasing Return
5 Acre	2	12	6	7	Increasing Return
5 Acre	3	21	7	9	Increasing Return
5 Acre	4	28	7	7	Decreasing Return
5 Acre	5	30	6	2	Decreasing Return
5 Acre	6	30	5	0	Decreasing Return
5 Acre	7	28	4	-2	Negative Return
5 Acre	8	24	3	-4	Negative Return

Table No. 4.1 reveals the relationship between the change input factor (Labour) and the output. The table also shows us the change in a variable factor of labour to the changes in total, average and marginal production. The detail explanation of this table can be given with the help of following 3 stages.





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## Stage First: Increasing Returns

In the first stage is called the stage of increasing returns. The Table No. 4.1 shows us that the total, average and marginal production increases up to the appointment of 3rd labour. This is happens due to the proper utilisation of fixed factor i.e. land in the production process.

## Stage Second: Decreasing Returns

In the 2nd stage of short-run function is of the decreasing returns stage. In this stage, the total production increases up to 30 quintal and then becomes constant, average production decreases from 7 to 5 quintal and marginal production decreases from 7 to 0 quintals. This is happening due to the scarcity of fixed factor (land) as compared to the variable factor i.e. labour.

## Stage Third: Negative Returns

In short-run production function, the third stage is of negative return stage. In this particular stage, as per increase in variable factor i.e. labour, the total and average production decreases from 28 to 24 and 4 to 3 quintal respectively. However, one most important thing happens in this stage i.e. the negative returns of marginal production from – 2 to – 4 quintal. In this stage, fixed factor becomes inadequate in relation to variable factors i.e. labour. So that excess quantity of variable factor, the sign of negative returns have been seen in the production process. Thus, short-run production function reveals the relationship between inputs and output in short-run period. It also gives us practical significance of agricultural sector situation.

Now we shall clear this short-run production function with the help of figure No. 4.1.

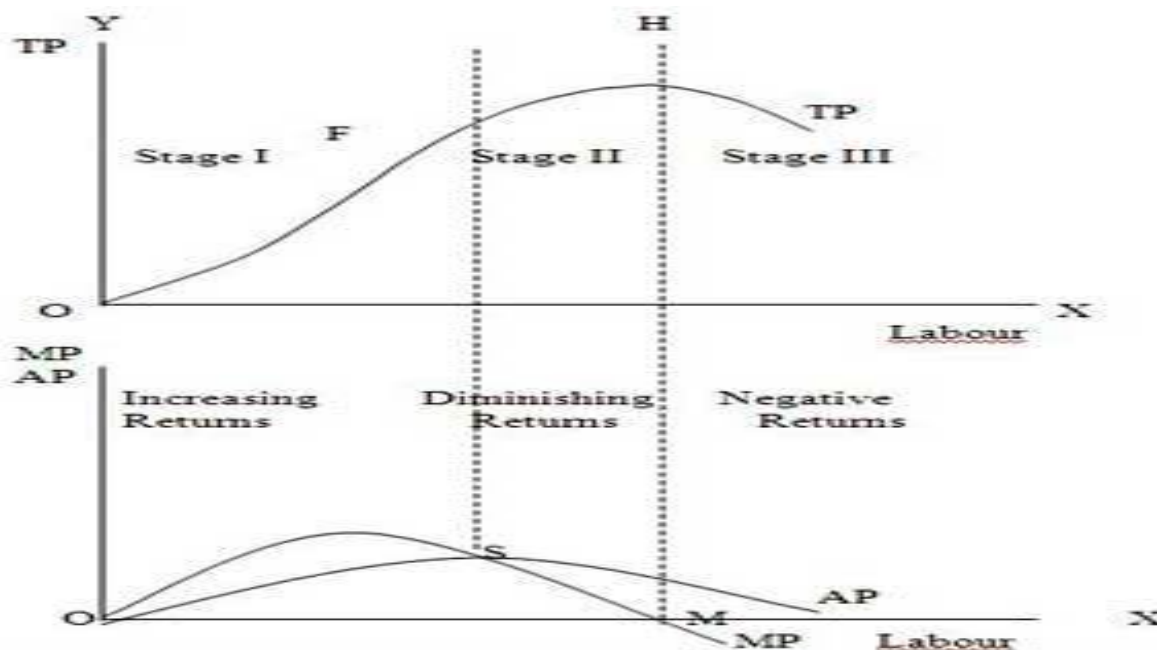


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## Assumptions of Short-run Production Function

The short-run production function is based on the following assumptions.

- The stage of technology is constant.
- The input factor labour is variable and other factors are fixed.
- The combination of fixed and variable factors is fixed within the short-run period.
- The prices of variable factors are fixed within the period.

In this way, short-run production function implies the restricted set of choice which can be varied only by changing the variable factors in the production process.

## Long-run Production Function

In the long-run period, all factors of production becomes variable. So that the relationship between input factors and production level will be, differ from the short run period. Thus, the long-run production function denotes the changing nature of inputs and out-put in the production process. When we increase the size of inputs, the level of production will of three main stages. I.e. increasing returns, constant returns and decreasing returns.



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## Explanation of Long-run Production Function:

We can explain the long-run production and the stages of it with a numerical example given below. Suppose land and labour are the two variable factors used in the production process by the organiser. When these two input factors used in the production by 1:2 ratio, the changes in the total and marginal production should be as under, shown in the Table No. 4.2

Table No. 4.2

### Long-Run Production Function

Land (Acre)	Labour	Total Production (Quintals)	Marginal Production (Quintals)	Stages of Function
2	1	5	5	Increasing Return
4	2	11	6	Increasing Return
6	3	18	7	Increasing Return
8	4	26	8	Constant Return
10	5	34	8	Constant Return
12	6	41	7	Decreasing Return
14	7	47	6	Decreasing Return
16	8	52	5	Decreasing Return

**Analysis of the table:** The three stages shown in the Table No. 4.2 can be explained as follows.

#### A) Increasing Returns Stage:

In the first phase of long-run production function, we experience that as per increase in the inputs of labour and land in the 1 : 2 ratio, the total and marginal production increases by 5 quintal to 18 quintals and 5 quintals to 7 quintals respectively. This increasing trend of marginal and total production is caused by the proper use of inputs and due to the economies of scale.



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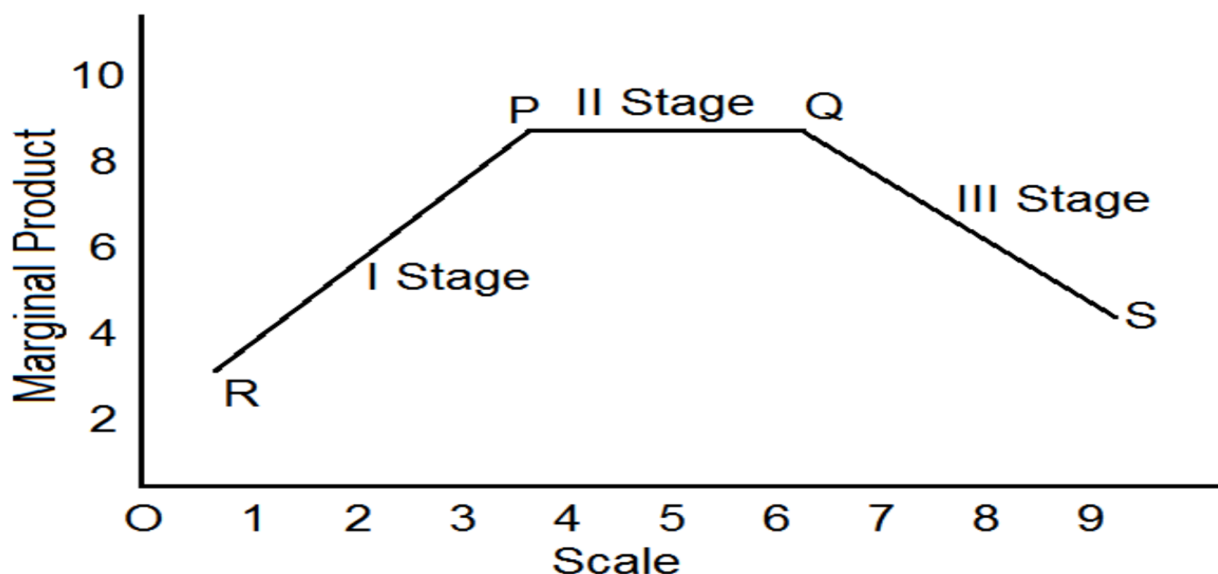
## B) Constant Returns Stage :

The second stage of long-run production function is of constants return stage. In this stage, when the input factors of labour and land will be increased propotionately, the marginal production becomes constant i.e. 8 quintals. The basic cause of constant returns is the ideal combination of inputs and output as well as optimum economies of scale in the production process.

## C) Decreasing Return Stage:

In the third stage of long-run production, function is of decreasing returns stage. In this particular stage, when inputs increases in the ratio 1 : 2, total production increases slowly from 41 quintals to 52 quintals but marginal production decreases from 7 quintals to 5 quintals. This is happens due to the diseconomies of scale in the production process. We can realise the long-run production function with help of Figure No. 4.2 given below.

Figure 1





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## UNIT 3 COST FUNCTION

### What is Fixed Cost vs Variable Cost?

Fixed cost vs variable cost is the difference in categorizing business costs as either static or fluctuating when there is a change in the activity and sales volume. Fixed cost includes expenses that remain constant for a period of time irrespective of the level of outputs, like rent, salaries, and loan payments, while variable costs are expenses that change directly and proportionally to the changes in business activity level or volume, like direct labor, taxes, and operational expenses.

### Definition of Fixed Expenses

Fixed expenses cost the same amount each month. These bills cannot easily be changed and are usually paid on a regular basis, such as weekly, monthly, quarterly or from year to year. It is much easier to budget for fixed expenses than it is to budget for a variable expense or discretionary expense.

Typical household fixed expenses are mortgage or rent payments, car payments, real estate taxes and insurance premiums. While you could theoretically change your monthly mortgage payment by refinancing your loan or by appealing your property tax assessment, this is not an easy switch.

The same is true if you pay rent. You could change this expense by moving to a cheaper home or by getting a roommate, but these are major lifestyle changes.

Your health insurance, car insurance, life insurance and homeowners or renters insurance are also examples fixed costs. You would have to spend several hours researching alternate plans to change these monthly payment amounts.

### Definition of Variable Costs

Variable expenses represent those daily spending decisions like eating at restaurants, buying clothes, drinking Starbucks and playing a round of golf with your friends.



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These costs are not considered variable because they are discretionary. Rather, they are "variable" because the amount that you spend differs from month-to-month.

While most variable costs represent discretionary spending (such as restaurants, Starbucks and golf), some variable costs represent necessities.

Most families, for example, spend variable amounts of money on groceries each month. In addition, you are likely to spend different amounts each month on putting gasoline in your car and paying for necessary car repairs and maintenance

## What Is Fixed Cost and Variable Cost? Examples

### **1. FIXED COSTS EXAMPLE**

Fixed costs remain constant for a specific period. These costs are often time-related, such as the monthly salaries or the rent.

For example, the rent of a building is a fixed cost that a small business owner negotiates with the property owner based the square footage needed for its operations. If the owner rents 10,000 square feet of space at \$40 a square foot for ten years, the rent will be \$40,000 per month for the next ten years, regardless of the profits or losses.

It is important to note that fixed costs are not constant in the end. Take the example above. The rent will be the same until the business occupies the space or till the landlord decides to increase the rent after the end of the lease agreement. If the owner decides to move to a bigger facility or pay more, the business expense would obviously go up.

### **2. VARIABLE COSTS EXAMPLE**

Variable costs change directly with the output – when output is zero, the variable cost will be zero. The total variable cost to a business is calculated by multiplying the total quantity of output with the variable cost per unit of output.

A common example of variable costs is operational expenses that may increase or decrease based on the business activity. A growing business may incur more



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Ph. No–(0281)2471645

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operating costs such as the wages of part-time staff hired for specific projects or a rise in the cost of utilities – such as electricity, gas or water.

## Opportunity Cost

Since resources are limited, every time you make a choice about how to use them, you are also choosing to forego other options. Economists use the term **opportunity cost** to indicate what must be given up to obtain something that is desired. A fundamental principle of economics is that every choice has an opportunity cost. If you sleep through your economics class (not recommended, by the way), the opportunity cost is the learning you miss. If you spend your income on video games, you cannot spend it on movies. If you choose to marry one person, you give up the opportunity to marry anyone else. In short, opportunity cost is all around us.

The idea behind opportunity cost is that the cost of one item is the lost opportunity to do or consume something else; in short, opportunity cost is the value of the next best alternative.

Since people must choose, they inevitably face trade-offs in which they have to give up things they desire to get other things they desire more.

## Sunk Cost

A sunk cost applies to money previously invested and not recoverable. In any industry, the axiom that one must "spend money to make money" is expressed in the sunken cost phenomenon. A sunk cost varies from the potential costs that a company may face, such as decisions about the cost of purchasing inventories or pricing of goods. Sunk costs are removed from possible business decisions because, regardless of the result of a decision, the cost will remain the same.

Organizations must consider current/relevant costs when making strategic decisions that include the future costs that need to be incurred. The relevant costs are compared to the revenue contribution of two different choices. A sunk cost is not considered because they do not alter one's choice.

For instance, a manufacturing company may have a variety of sunk costs, such as machinery costs, equipment costs, land and factory lease expenses. Sunk costs





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are excluded while calculating the cost of deciding between a further sell or a buying process.

### **What is a Sunk Cost?**

A sunk cost is a cost that an entity has incurred, and which it can no longer recover. Sunk costs should not be considered when making the decision to continue investing in an ongoing project, since these costs cannot be recovered. Instead, only relevant costs should be considered. However, many managers continue investing in projects because of the sheer size of the amounts already invested in prior periods. They do not want to "lose the investment" by curtailing a project that is proving to not be profitable, so they continue pouring more cash into it. Rationally, they should consider earlier investments to be sunk costs, and therefore exclude them from consideration when deciding whether to continue with further investments.

An accounting issue that encourages this adverse behavior is that capitalized costs associated with a project must be written off to expense as soon as the decision is made to cancel the project. When the amount to be written off is quite large, this encourages managers to keep projects running over a longer period, so that the expense recognition can be spread out over a longer period, in the form of depreciation.

**Incremental Cost** – Incremental costs are the additions to costs resulting from a change in the nature and level of business activity e.g., change in product line or output level, adding or replacing a machine, changing distribution channels etc. Incremental costs are also known as avoidable costs or escapable costs because these costs can be avoided by not bringing about any change in the activity. Furthermore, since incremental costs can also be regarded as the difference in total costs resulting from a contemplated change, they are also referred to as differential costs.





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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

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Nr. Amrapali Railway  
Raiya Road, Rajkot – 360001  
Ph.No–(0281)2440478, 2472590

## What is accounting cost?

Accounting cost, like accounting profit, follows the basic principles of Accounting. In simpler terms, accounting cost is the overall cost of anything your business has paid for.

These costs include the following:

- Rent
- Utility expenses
- Food and entertainment expenses
- Travel expenses, including transportation and hotels
- Payroll expenses, including salaries and related payroll taxes
- Supplies
- Insurance
- Any other expenses incurred during the normal course of business

All of the expenses listed above are considered explicit costs, which means they are direct costs associated with your business. These costs are automatically accounted for each time an expense is recorded in your accounting software or ledgers.

As long as you know how to track business expenses, and all of your financial transactions are properly recorded, there is no additional work necessary in order to calculate accounting cost

## **What is economic cost?**

Economic cost is a step further than typical bookkeeping basics and is often used by economists to compare two separate courses of action. It also looks at the impact each action would have on your business. Economic cost is calculated by taking your accounting cost, which has already been calculated, and subtracting any implicit costs.

Implicit costs are calculated by analyzing your current resources and estimating the cost of those resources, as well as their impact to your business, should you decide to utilize them in a different way.

## **Accounting cost vs. economic cost: What is the difference?**

To understand accounting cost and economic cost, you must first understand the difference between explicit and implicit costs.



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Ph. No–(0281)2471645

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## Explicit costs

Explicit costs are the total costs of doing business throughout the year. Explicit costs are everything from the cost of the office you rent to the salary you pay your employees.

Accountants use accounting cost to determine the profitability and financial health of your business since you will need to determine accounting costs prior to determining accounting profit.

## Implicit costs

Implicit costs are designed to be used when making decisions. Implicit costs are often used by businesses looking to make strategic decisions, or to determine the true cost of a business decision they are considering.

## Economic and accounting costs

Accounting costs	Economic costs
<ul style="list-style-type: none"><li>• The actual (explicit) costs involved in production</li><li>• E.g. Mortgage, rent, power, raw materials, wages, etc.</li></ul>	<ul style="list-style-type: none"><li>• Accounting cost (explicit) + the opportunity costs (implicit) of the resources used.</li><li>• E.g. The rent lost by the owner of a factory whose firm currently uses the building</li></ul>



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## Average Cost

**Definition:** It is the total cost of making a single product calculated by dividing the Total cost by the number of product manufacture. The most important components in average cost are fixed cost and Variable cost. It is also called as Unit cost.

### **Formula:**

Total Cost (Fixed Cost + Variable Cost) / by Number of units Manufactured

The above formula shows that the average cost is directly related to the number of units manufactured; If it is increased, averaged cost per unit will decline; If its decreased, average cost per unit will increase.

## **Marginal Cost**

**Definition:** It is a cost incurred due to the change in total cost due to an increase in the unit of product. So it is an additional cost or extra cost as a result of an increase in the production of one more unit of product. The most important component in marginal cost is the variable cost of production. Marginal cost plays an important role in the business for the decision-making process. When the company performs a financial analysis that times management evaluate the pricing of each product offered to consumers that time management console marginal costing analysis.

### **Formula:**

Change in Total Cost / Change in number of units Manufactured

## Short Run Cost Function

The cost function is a functional relationship between cost and output. It explains that the cost of production varies with the level of output; given other things remain the same (*ceteris paribus*). This can be mathematically written as:

$$C = f(X)$$

Where C is the cost of production and X represents the level of output.



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## Total Fixed Cost

Fixed cost refers to the cost of fixed inputs. It does not change with the level of output (thus, fixed). Fixed inputs include building, machinery etc. Hence the cost of such inputs such as rent or cost of machinery constitutes fixed costs. Also referred to as *overhead costs*, *supplementary costs* or *indirect costs*, these costs remain the same irrespective of the level of output.

Hence, if we plot the Total Fixed Cost (TFC) curve against the level of output on the horizontal axis, we get a straight line parallel to the horizontal axis. This indicates that these costs remain the same and that they have to be incurred *even if the level of output is zero*.

## Total Variable Cost

The cost incurred on variable factors of production is called Total Variable Cost (TVC). These costs vary with the level of output or production. Thus, when production level is zero, TVC is also zero. Thus, the TVC curve begins from the origin.

The shape of the TVC is peculiar. It is said to have *an inverted-S shape*. This is because, in the initial stages of production, there is scope for efficient utilization of fixed factor by using more of the variable factor (e.g. Workers employing machinery).

Hence, as the variable input employed increases, the productive efficiency of variable inputs ensures that the TVC increases but at a *diminishing rate*. This makes the first part of the TVC curve that is *concave*.

As the production continues to increase, more and more variable factor is employed for a given amount of fixed input. The productive efficiency of each variable factor falls and it adds more to the cost of production. So the TVC increases but now at an *increasing rate*. This is where the TVC curve is *convex* in shape. Therefore, the TVC curve gets an inverted-S shape.



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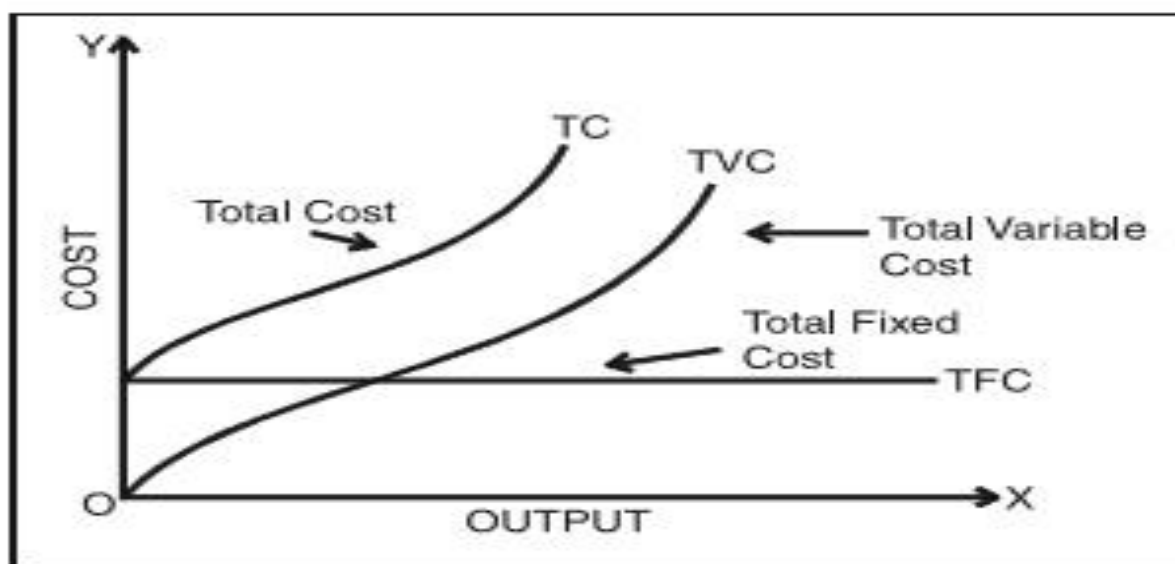
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## Total Cost

Total cost (TC) refers to the sum of fixed and variable costs incurred in the short-run. Thus, the short-run cost can be expressed as

$$TC = TFC + TVC$$

Note that in the long run, since  $TFC = \text{zero}$ ,  $TC = TVC$ . Thus, we can get the shape of the TC curve by summing over TFC and TVC curves.



**Fig. 5 : Short run Total Cost Curves**

The following can be noted about the TC curve:

- The TC curve is inverted-S shaped. This is because of the TVC curve. Since the TFC curve is horizontal, the difference between the TC and TVC curve is the same at each level of output and equals TFC. This is explained as follows:  $TC - TVC = TFC$
- The TFC curve is parallel to the horizontal axis while the TVC curve is inverted-S shaped.



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- Thus, the TC curve is the same shape as TVC but begins from the point of TFC rather than the origin.
- The law that explains the shape of TVC and subsequently TC is called the law of variable *proportions*.

## Short Run Average Costs

While the total cost of production helps firms understand the overall expenses incurred, the average costs help identify the expenditures involved in manufacturing a single unit. In this article, we will look at the short run average costs and marginal costs of production.

## Short Run Average Costs

### 1. Average Fixed Cost (AFC)

The average fixed cost is the total fixed cost divided by the number of units produced. Hence, if TFC is the total fixed cost and Q is the number of units produced, then

$$AFC = TFC / Q$$

Therefore, AFC is the fixed cost per unit of output.

Example: The TFC of a firm is Rs. 2,000. If the output is 100 units, the average fixed cost is,

$$AFC = TFC / Q = 2000 / 100 = \text{Rs. } 20$$

If the output is increased to 200 units, then

$$AFC = TFC / Q = 2000 / 200 = \text{Rs. } 10$$

Since TFC is constant, any increase in output decreases the AFC. Note that, while the AFC can become small, it is never zero.





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## 2. Average Variable Cost (AVC)

The second aspect of short-run average costs is an average variable cost. Average variable cost is the total variable cost divided by the number of units produced. Hence, if TVC is the total Variable cost and Q is the number of units produced, then

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

Therefore, AVC is the variable cost per unit of output.

Usually, the AVC falls as the output increases from zero to normal capacity output. Beyond the normal capacity, the AVC rises steeply due to the operation of diminishing returns.

## 3. Average Total Cost (ATC)

The average total cost is the sum of the average variable cost and the average fixed costs. That is,

$$ATC = AFC + AVC$$

In other words, it is the total cost divided by the number of units produced.

The diagram below shows the AFC, AVC, ATC, and Marginal Costs (MC) curves:

### Marginal Cost (MC)

Another concept to learn in short-run average costs is Marginal Cost. Marginal cost is the addition made to the cost of production by producing an additional unit of the output. In simpler words, it is the total cost of producing t units instead of t-1 units. Let us look at an example to understand this well:

A firm produces 5 units at a total cost of Rs. 200. For some reasons, it is required to produce 6 units instead of 5 and the total cost is Rs. 250. Therefore, the marginal cost is Rs. 250 – Rs. 200 = Rs. 50.



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A note about marginal costs: It is independent of fixed costs. This is because fixed costs do not change with the output. On the other hand, in the short run, the variable costs change with the output. Hence, marginal costs are due to changes in variable costs. Therefore,

$MC = \frac{\Delta TC}{\Delta Q}$  where  $\Delta TC$  is the change in the total cost and  $\Delta Q$  is the change in the output. This equation can also be written as:

$$MC_n = TC_n - TC_{n-1}$$

In the Fig. 1 below, you can see that the MC curve falls as the output increases in the beginning and starts rising after a certain level of the output. This is because of the influence of the law of variable proportions. Since the marginal product rises first, reaches a maximum and then declines, the marginal costs decline first, reaches its minimum and then rises.

Quantity <i>Q</i>	Total Cost $TC = TFC + TVC$	Marginal Cost $MC = \frac{\Delta TC}{\Delta Q}$	Total Fixed Cost <i>TFC</i>	Total Variable Cost <i>TVC</i>	Average Cost $AC = \frac{TC}{Q}$	Average Fixed Cost $AFC = \frac{TFC}{Q}$	Average Variable Cost $AVC = \frac{TVC}{Q}$
1	\$120	—	\$100	\$ 20		100.00	20.00
2	138	18	100	38	69.00	50.00	19.00
3	151	13	100	51	50.33	33.33	17.00
4	162	11	100	62	40.50	25.00	15.50
5	175	13	100	75	35.00	20.00	15.00
6	190	15	100	90	31.67	16.67	15.00
7	210	20	100	110	30.00	14.29	15.71
8	234	24	100	134	29.25	12.50	16.75
9	263	29	100	163	29.22	11.11	18.11
10	300	37	100	200	30.00	10.00	20.00

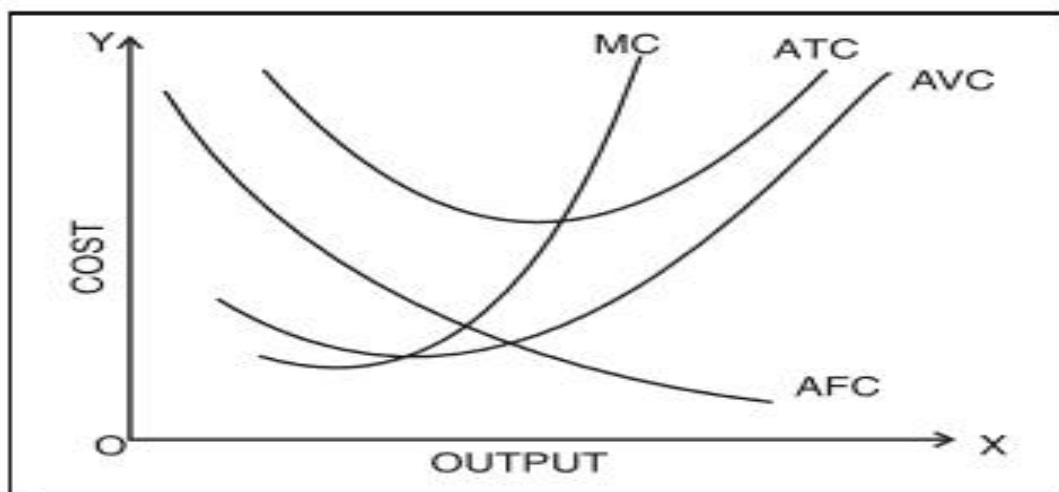


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**Fig. 1 : Short run Average and Marginal Cost Curves**

It is important to note that the behavior of the ATC curve depends upon that of the AVC and AFC curves. Observe that:

- In the beginning, both AVC and AFC curves fall. Hence, the ATC curve falls as well.
- Next, the AVC curve starts rising, but the AFC curve is still falling. Hence, the ATC curve continues to fall. This is because, during this phase, the fall in the AFC curve is greater than the rise in the AVC curve.
- As the output rises further, the AVC curve rises sharply. This offsets the fall in the AFC curve. Hence, the ATC curve falls initially and then rises.

## **Relationship between Average Cost and Marginal Cost**

- a. If the average cost falls due to an increase in the output, the marginal cost is less than the average cost.
- b. If the average cost rises due to an increase in the output, the marginal cost is more than the average cost.



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- c. Marginal cost is equal to the average cost when the marginal cost is minimum. You can see in Fig. 1 that the MC curve cuts the ATC curve at its minimum or optimum point.

## Long Run Cost Curves

The long run is different from the short run in the variability of factor inputs. Accordingly, long-run cost curves are different from short-run cost curves. This lesson introduces you to long run Total, Marginal and Average costs. You will learn the concepts, derivation of cost curves and graphical representation by way of diagrams and solved examples.

## **The Concept of the Long Run**

The long run refers to that time for a firm where it can vary all the factors of production. Thus, the long run consists of variable inputs only, and the concept of fixed inputs does not arise. The firm can increase the size of the plant in the long run. Thus, you can well imagine no difference between long-run variable cost and long-run total cost, since fixed costs do not exist in the long run.

## **Long Run Total Costs**

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

In graphically deriving the LTC curve, the minimum points of the STC curves at different levels of output are joined. The locus of all these points gives us the LTC curve.

## **Long Run Average Cost Curve**

Long run average cost (LAC) can be defined as the average of the LTC curve or the cost per unit of output in the long run. The division of LTC can calculate it by the quantity of output. Graphically, LAC can be derived from the Short run Average Cost (SAC) curves.



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While the SAC curves correspond to a particular plant since the plant is fixed in the short-run, the LAC curve depicts the scope for expansion of plant by minimizing cost.

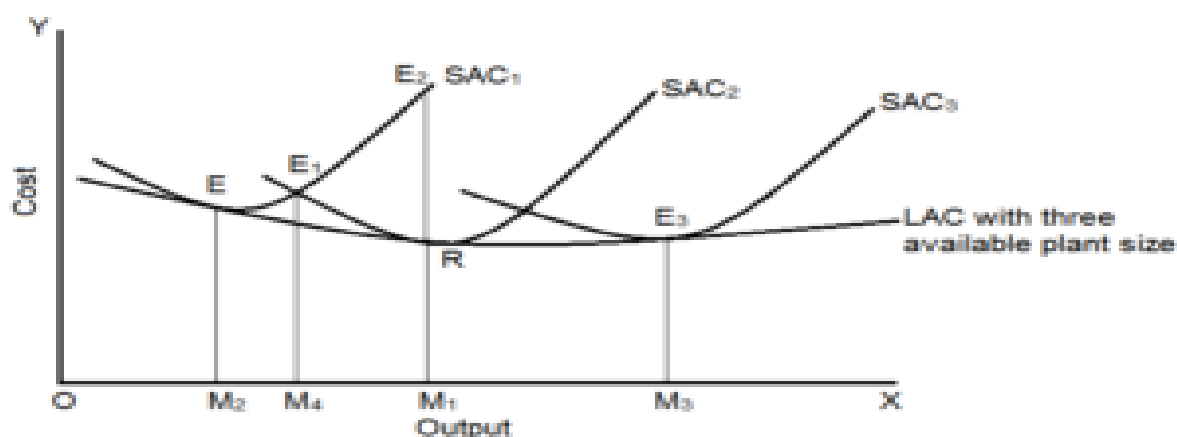
## Derivation of the LAC Curve

Note in the figure, that each SAC curve corresponds to a particular plant size. This size is fixed but what can vary is the variable input in the short-run. In the long run, the firm will select that plant size which can minimize costs for a given level of output.

You can see that until the  $OM_1$  level of output it is logical for the firm to operate at the plant size represented by  $SAC_2$ . If the firm operates at the cost represented by  $SAC_2$  when producing an output level  $OM_2$ , the cost would be more.

So in the long run, the firm will produce till  $OM_1$  on  $SAC_2$ . However, till an output level represented by  $OM_3$ , the firm can produce at  $SAC_2$ , after which it is profitable to produce at  $SAC_3$  if the firm wishes to minimize costs.

Figure 1



Thus, the choice, in the long run, is to produce at that plant size that can minimize costs. Graphically, this gives us a LAC curve that joins the minimum points of all possible SAC curves, as shown in the figure. Thus, the LAC curve is also called



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an envelope curve or planning curve. The curve first falls, reaches a minimum and then rises, giving it a U-shape.

We can use returns to scale to explain the shape of the LAC curve. Returns to scale depict the change in output with respect to a change in inputs. During Increasing Returns to Scale (IRS), the output doubles by using less than double inputs. As a result, LTC increases less than the rise in output and LAC will fall.

- In Constant Returns to Scale (CRS), the output doubles by doubling the inputs and the LTC increases proportionately with the rise in output. Thus, LAC remains constant.
- In Decreasing Returns to Scale (DRS), the output doubles by using more than double the inputs so the LTC increases more than proportionately to the rise in output. Thus, LAC also rises. This gives LAC its U-shape.

### Long Run Marginal Cost

Long run marginal cost is defined as the additional cost of producing an extra unit of the output in the long-run i.e. when all inputs are variable. The points of tangency between LAC and SAC derive the LMC curve.

Note an important relation between LMC and SAC here. When LMC lies below LAC, LAC is falling, while when LMC is above LAC, LAC is rising. At the point where  $LMC = LAC$ , LAC is constant and minimum.

## UNIT 4 EQUILIBRIUM OF FIRM

### Introduction

Market is a place where people can buy and sell commodities. It may be vegetables market, fish market, financial markets or foreign exchange markets. In economic language, market is a study about the demand for and supply of a





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particular item and its consequent fixing of prices, example bullion on market and foreign exchange market or a commodity market like food grains market etc.

Market is classified into various types based on the characteristic features. They are classified based on:

**Area:** family market, local, regional, national and international

**Time:** very short period, short period, long period, very long period

**Commodity:** produce exchange, bullion market, capital market, stock market

**Nature of Transaction:** spot market, forward market and futures market

**Volume of business:** wholesale market, retail market

**Importance:** primary market, secondary market, territory market

**Regulation:** regulated market, unregulated market

**Economics:** Perfect market and imperfect market

Market In Economic Sense Implies:

1. Presence of buyers and sellers of the commodity
2. Establishment of contact between the buyer and seller
3. Similarity of the product
4. Exchange of commodity for a price

Classification Of Market Structure Based On The Nature Of Competitor: **1. Perfect market 2. Imperfect market**

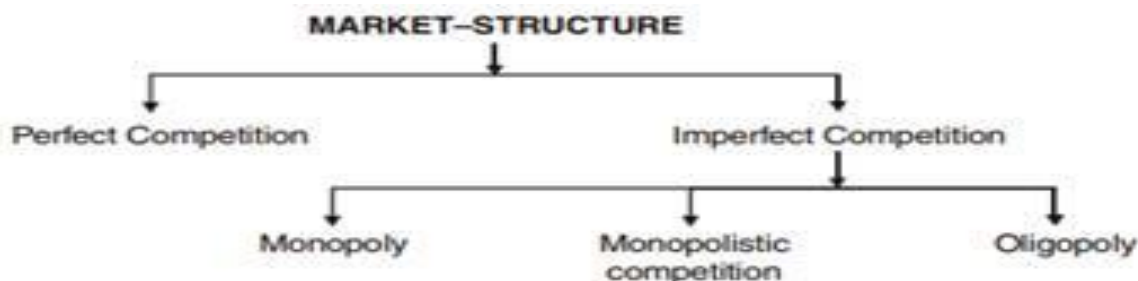


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## Perfect Competition

Perfect competition is said to prevail there is a large number of producers producing a homogeneous product. The maximum output, which in individual firm can produce, is very small relatively to the total demand of the industry product so that a firm cannot affect the price by varying its supply of output. Perfect competition is a condition of market in which there exist very large number of buyers and sellers of a homogeneous product having no control over price. According to Mrs. Joan Robinson, "Perfect competition prevails when the demand for the output of each producer is perfectly elastic." This clears, first, that the number of sellers is large so that the output of any one seller is negligibly small proportion of the total output of the commodity and the second that the products of various sellers are homogeneous from the viewpoint of consumers.

### **Characteristic features of Perfect Competition:**

- 1. Number of buyers:** The number of buyers is very large, so large that no single buyer, by his individual or collective action with other buyers, can influence market price by changing demand. This is because the demand of a single buyer is very small part of the total demand in the market. Hence, it is beyond the power of a single buyer to influence market price. Consequently, he has to accept the market price as given and adjust his demand to it. The buyer is a price taker in this market.
- 2. Number of Sellers:** The number of sellers also is very large, so large that no single seller, by his individual or collective action with other sellers, can influence market price by changing supply. This is because the supply of a single seller is very small part of the total supply in the market. The analogy of an atom can be used to indicate this share. Hence, it is beyond the power of a single seller to influence market price. Consequently, he also has to



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accept the market price as given and adjust his supply to it. The seller is a price taker in this market.

- 3. Homogeneous Products:** The important feature of perfect competition is that, the products produced by all firms in the industry are fully homogeneous and identical. It means that the products of various firms are indistinguishable from each other; they are perfect substitute to one another. Therefore, the buyer cannot distinguish between the output of one firm and that of another and so is indifferent as to the particular firm from which he or she buys.
- 4. Free Entry and Exit:** There is a free entry in the market for newcomers. The reason is simple. As the share of each seller in the market is too small, any addition to the supply by a newcomer firm would also be too small to effect any price change. Since, in the short run, firms can neither change the size of their plants, nor new firms can enter or old ones can leave the industry, the condition of free entry and exit therefore applies only to the long-run equilibrium under perfect competition. In the event of super normal profit, the firms used to enter the industry and may leave the industry when losses are inescapable.
- 5. Knowledge of the Market:** Resource owners, sellers and buyers possess perfect knowledge of as to the present and future prices, costs and economic opportunities in general. Thus, consumers will not pay a higher price than necessary for the commodity. Price differences are quickly eliminated and a single price will prevail throughout the market for the commodity.
- 6. Absence of Selling and Transport cost:** There is a absence of selling and transport costs in the perfect competition. An individual firm is merely a price-taker; it can sell whatever quantity of the product it likes, at the prevailing price-level. It is further presumed that there is no transport cost under perfect competition and hence there is uniformity in the price level throughout the market.
- 7. Nature of Demand Curve:** The firm is able to sell any quantity at the given market price. Therefore, its demand curve is perfectly elastic at the level of going market price.



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8. **Other Factors:** There is no government intervention in the market; there is perfect mobility of factors of production. In sum, perfect competition is an ideal condition of market and hence normally it does not exist in reality.

### Equilibrium of Firm under Perfect Competition:

#### **What is Equilibrium of Firm?**

The word equilibrium has been taken from science. It is a state of no change where opposite forces become equal. The consumer is in equilibrium when he is getting maximum satisfaction from his income. Similarly, for an industry, equilibrium refers to a situation when there is no tendency for new firms to enter or exit. Now, the question arises, under what conditions such equilibrium situations will be achieved.

#### **Equilibrium of Firm:**

“A firm is a unit engaged in the production for sale at a profit and with the objective of maximizing profit.” -Watson

A firm is in equilibrium when it is satisfied with its existing level of output. The firm will, in this situation produce the level of output which brings in greatest profit or smallest loss. When this situation is reached, the firm is said to be in equilibrium.

“Where profits are maximized, we say the firm is in equilibrium”. -Prof. RA. Bilas

“The individual firm will be in equilibrium with respect to output at the point of maximum net returns.” -Prof. Meyers

#### **Conditions of the Equilibrium of Firm:**

**A firm is said to be in equilibrium when it satisfies the following conditions:**



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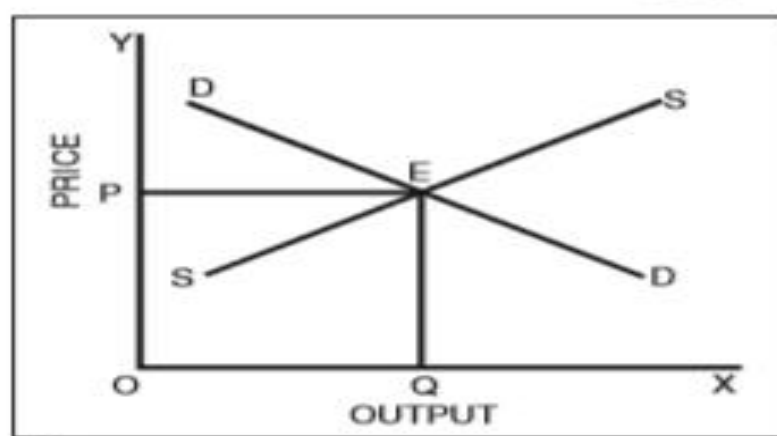
1. The first condition for the equilibrium of the firm is that its profit should be maximum.
2. Marginal cost should be equal to marginal revenue.
3. MC must cut MR from below.

## Price Determination under Perfect Competition:

Under perfect competition, many factors influence the determination of the price of goods. In this article, we will look at the equilibrium of the industry and the equilibrium of a firm as important factors behind price determination under perfect competition

## Equilibrium of the Industry under Perfect Competition

In economic terms, an industry consists of many independent firms. Each firm has a number of factories, farms or mines, as required. Each such firm in industry produces a homogeneous product. Equilibrium of the industry happens when the total output of the industry is equal to the total demand. In such a scenario, the prevailing price of a commodity is its equilibrium price. We know that under competitive conditions, the interaction of demand and supply determines the equilibrium price as shown below:



**Fig. 1 : Equilibrium of a competitive industry**



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In Fig. 1 above, OP is the equilibrium price. Further, OQ is the equilibrium quantity sold at that price. Now, the equilibrium price is the price at which both the demand and supply are equal. In other words, no buyer, who wanted to buy at that price, goes dissatisfied and no seller, who wanted to sell his goods at that price, goes dissatisfied either. Note that with the demand remaining the same, if the price is higher or lower than OP, then the market is not in equilibrium. Also, if goods are lesser or higher than the demand, the equilibrium is not attained.

## Equilibrium of the Firm under Perfect Competition

A firm is in equilibrium when it maximizes its profits. Hence, the output that offers maximum profit to a firm is the equilibrium output. When a firm is in equilibrium, there is no reason to increase or decrease the output.

In a competitive market, firms are price-takers. The reason being the presence of a large number of firms who produce homogeneous products. Therefore, firms cannot influence the price in their individual capacities. They have to follow the price determined by the industry.

The following figure shows a firm's demand curve under perfect competition:

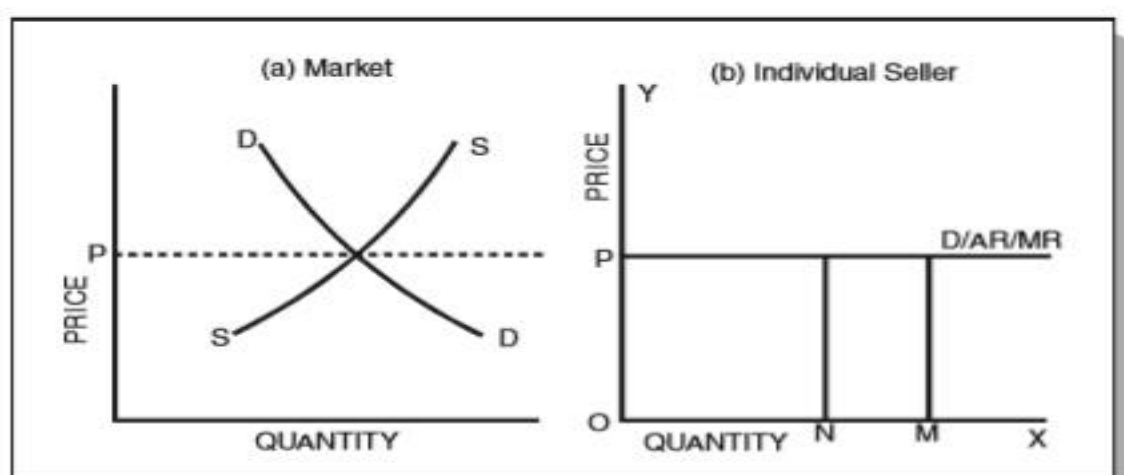


Fig. 2 : The firm's demand curve under perfect competition





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From Fig. 2 above, you can see that the industry price,  $OP$ , is fixed throughout the interaction of demand and supply of the industry. Firms have to accept this price. Hence, they are price-takers and not price-makers. Hence, they cannot increase or decrease the price  $OP$ . Therefore, the line  $P$  acts as a demand curve for such firms. Hence, in perfect competition, the demand curve of an individual firm is a horizontal line at the level of the industry-set market price. Firms have to choose the level of output that yields maximum profit.

### Conditions for the equilibrium of a firm

To attain an equilibrium position, a firm must satisfy the following two conditions:

They must ensure that the marginal revenue is equal to the marginal cost ( $MR = MC$ ).

- If  $MR > MC$ , the firm has an incentive to expand its production and sell additional units.
- If  $MR < MC$ , the firm must reduce the output since additional units add more cost than revenue.
- The firm gets maximum profits only when  $MR = MC$ .

The  $MC$  curve must have a positive slope and cut the  $MR$  curve from below.



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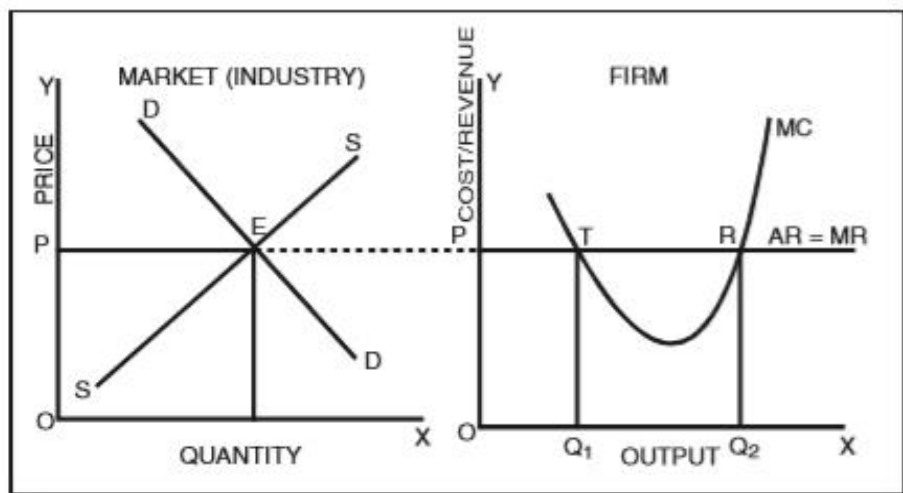


Fig. 3 : Equilibrium position for a firm under perfect competition

In Fig. 3 above, DD is the demand curve and SS is the supply curve. They equilibrate at point E and set the market price as OP. Under perfect competition, firms adopt OP as the industry price and consider the P-line as the demand curve or AR – average revenue curve (perfectly elastic at P). Since all units are equally priced, the MR curve is a horizontal line and is equal to the AR line. Observe that the curve MC cuts the MR curve at two points – T and R. At point T, the MC curve cuts the MR curve from above whereas at point R it cuts the MR curve from below. Therefore, according to the conditions of equilibrium of a firm, point R is the point of equilibrium and  $OQ_2$  is the equilibrium level of output.

We know that under perfect competition every firm/buyer behaves as a ‘**price-taker**’. To all, price is given and known. However, this price is determined in the competitive industry in the short run by short run demand and supply curves for the industry.

All firms and buyers accept this price, once determined in this way. No one has the power to influence the price. Against this backdrop of market price, a firm aims at maximizing its profit by producing a certain level of output where  $P = MC$ .

The equilibrium output of a competitive firm operating in the short run has been shown in Fig. 4.3 where the revenue and cost curves have been drawn. It is to be kept in mind that a firm in the short run may enjoy abnormal profit if total revenue



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(TR) exceeds total cost (TC). Further, it may incur loss in the short run if TC exceeds TR. Alternatively, it may earn only normal profit if TR equals TC.

All these three possibilities have been shown in Fig. 4.3. Fig. 4.3(a) describes supernormal profit enjoyed by Firm A. Fig. 4.3(b) shows normal profit enjoyed by Firm B and Fig. 4.3(c) shows loss incurred by Firm C. In all the figures, curves labeled as SAC and SMC are known as short run average cost and short-run marginal cost curves.

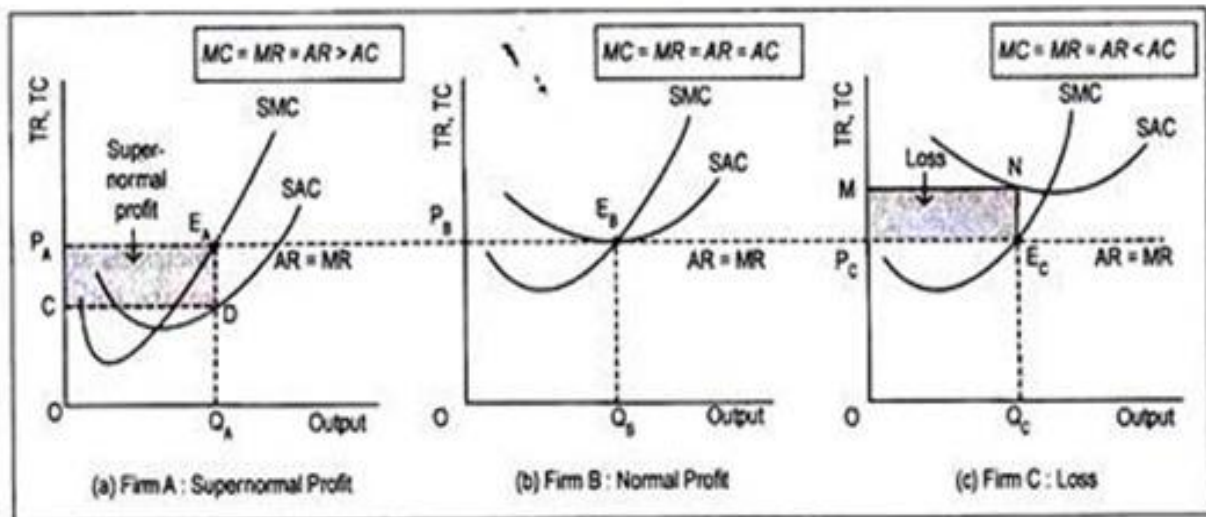


Fig. 4.3: Short Run Equilibrium of Firm

Firm A is in equilibrium at point  $E_A$  since at this point both the conditions for equilibrium have been satisfied.

Corresponding to this equilibrium point, profit-maximizing volume of output becomes  $OQ_A$ . Firm A now earns revenue to the extent of  $OP_A E_A Q_A$  from the sale of output of  $OQ_A$ . And, it incurs a cost of production to the extent of  $OCDQ_A$ . Since revenue exceeds cost, Firm A earns supernormal profit by the amount  $P_A E_A DC$ .

For Firm B, equilibrium output is  $Q_B$  corresponding to the equilibrium point  $E_B$ . Since revenue ( $OP_B E_B Q_B$ ) for  $OQ_B$  output is the same as that of its cost of



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production ( $OP_B E_B Q_B$ ), Firm B enjoys only normal profit. Point  $E_B$  may be called break-even point since revenue equals cost.

Firm C incurs a loss though it attains equilibrium at point  $E_C$ . In other words, a competitive firm may reach equilibrium even after incurring losses. Here, loss amounts to the area  $P_C E_C N M$ , since costs exceed revenue.

**Thus, a firm in the short run may:**

(i) Earn supernormal profit if

$$SMC = MR = AR > SAC;$$

(ii) Earn normal profit if

$$SMC = MR = AR = SAC; \text{ and}$$

(iii) Suffer a loss if

$$SMC = MR = AR < SAC.$$

Note that although the ‘**golden rule of output**’ determination is satisfied, the firm in the short run incurs a loss.

Will a firm continue in business if it incurs a loss in the short run? In the short run, even after making negative profit (i.e., loss), a firm will stay in business if it can manage variable costs. A firm in the short run faces both fixed and variable costs.

If no output is produced, the firm should bear fixed costs. So it must produce in the short run in such a way that it covers up at least variable costs. Then loss will be equivalent to fixed costs only. However, it will go out of business only if it fails to cover up variable costs from the sale of goods.

It will maximize profit only if it becomes an ‘**economic drop out**’ by discontinuing production. Here ‘**drop out**’ is paying.



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### **Equilibrium of a Competitive Firm in the Long Run:**

Long run is that time when firms can adjust their fixed inputs. In other words, a firm in the long run can change its scale of production as well as output to achieve maximum profit. If some firms earn excess profit in the long run, new firms will be attracted to enter the industry. Similarly, whenever some firms incur losses for a long time, they will go out of business.

This happens because, in the long run, under perfect competition, entry and exit are easy and free. As a result, all firms in the industry enjoy only normal profit. In the long run, free entry and exit of firms ensure that abnormal profits or losses will be wiped out completely.

Fig. 4.4 explains long run adjustment of a competitive firm where LMC and LAC represent the long run marginal and average cost curves. Corresponding to the price OP, the typical firm is in equilibrium at point E. The equilibrium output, thus determined, is OQ\* and the firm is making only normal profit.

### **Thus equilibrium conditions in the long run become:**

(i)  $AR = P = LMC$ , and

(ii)  $P = LAC$ .



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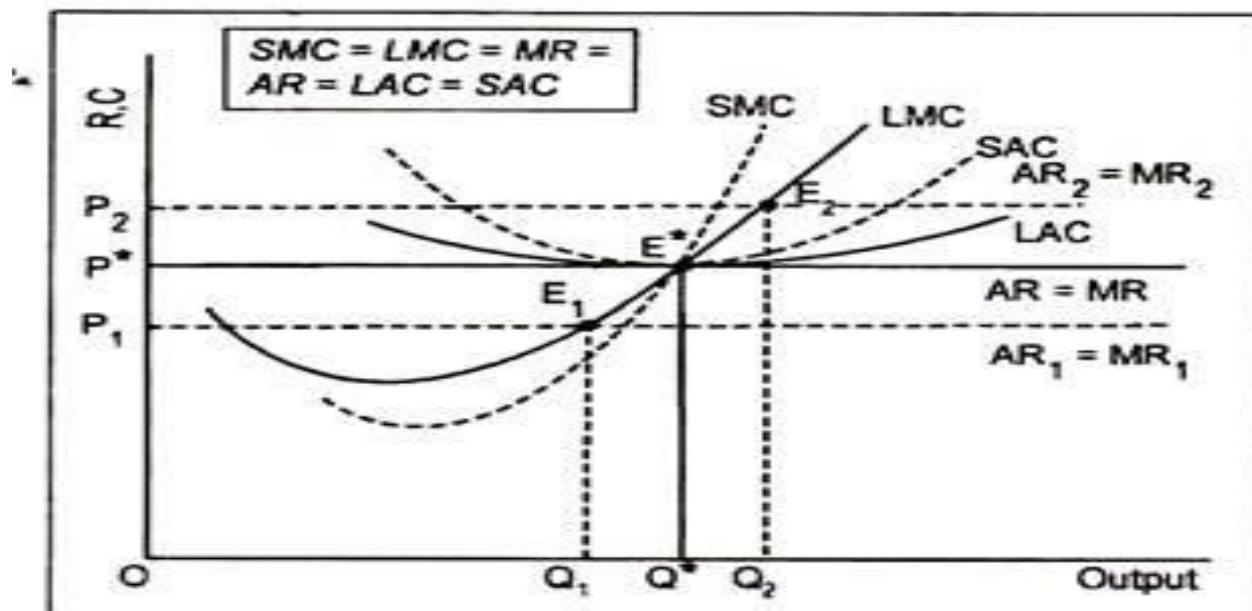


Fig. 4.4: Long Run Equilibrium of a Firm

It can also be written as:

$$LMC = LAC = P$$

LMC equals LAC at the latter's minimum point i.e., point E\*. At the equilibrium point, SMC equals LMC and SAC equals LAC. Thus, given the above equilibrium conditions, we have

$$SMC = LMC = SAC - LAC = P = MR$$

However, the firm cannot be in equilibrium in the long run at a price greater or less than  $OP^*$ . At a price  $OP_2$ ,  $LMC > LAC$ . Thus, point  $E_2$  cannot be described as a long run equilibrium one. Corresponding to point  $E_2$ , the firm produces  $OQ_2$  output and gets excess profit.

This will attract new firms to join the industry until excess profit is wiped out. Entry of new firms will cause output in the industry to rise. Thus, supply will rise and price will continue to decline until  $OP^*$  price is reached where only normal profit will be enjoyed.





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Similarly, at the price  $OP_1$ , though the firm is in equilibrium at point  $E_1$ , it incurs a loss since  $LMC < LAC$ . Loss-making firms will, however, leave the industry. Consequently, output and supply in the industry will decline. This will cause price to rise to  $OP^*$  where there is no incentive on the part of the firms to leave. At this price, every firm is making only profit. Pure profits or losses are eliminated in the end.

Finally, long run equilibrium of a competitive firm is always attained at the minimum point of the LAC curve. This means that the firm is capable of utilizing its plant optimally. Operation at the lowest point of LAC also implies that the resources of the society are optimally utilized. This is where efficiency of perfect competition lies.

## Monopoly Market

Mono means single, poly means seller and hence monopoly is a market structure where only one sells the goods and many buyers buy the same. Monopoly lies at the opposite extreme from perfect competition on the market structure continuum. A firm produces the entire supply of a particular good or service that has no close substitute.

### **Characteristic Features of Monopoly:**

There are different forms of monopoly itself. However, in the present context, simple monopoly will be taken into consideration.

Different features of monopoly are as under:

1. **Large Number of Buyers:** The number of buyers is very large, so large that no single buyer, by his individual or collective action with other buyers, can influence market price by changing demand. This is because the demand of a single buyer is a very small part of the total demand in the market. The analogy of an atom can be used to indicate his share. Hence, it is beyond the power of single buyer to influence market price. The buyer is the price taker in this market.
2. **Single Seller:** Under Monopoly, one firm is the sole producer or seller of a product. The single producer may be in the form of an individual owner of a single partnership or a joint stock company. Whatever be the constitution, it implies 'control over supply'. It is through this the



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monopolist gets a power to control market price of his product. Therefore, a monopolist is a price-maker.

- 3. Nature of the Commodity:** The commodity is homogeneous, that is, identical in all respects. There is no close substitute for the product of that firm should be available. However, remote substitutes may be there. Cross elasticity of demand for the commodity is not zero. Moreover, price discrimination is ruled out and hence the monopolist charges the same price from all buyers for the same product.
- 4. Entry in the Market:** For the newcomer firm's entry in monopoly market is difficult. The monopolist restricts the entry of new firms by following legal protections like patents, copyrights, sole operation etc. or by barriers like price-cutting, forming cartel, huge capital investment etc. Entry of new firms leads to strong competition, which the monopolists would like to avoid.
- 5. Demand Curve:** The entire demand curve of the consumers for a product faces the monopolist. The monopolists face a downward sloping demand curve since the demand curve of the consumers for a product slopes downward. If he wants to increase the sales, he must lower the price. He can raise the price if he is prepared to sacrifice some falls.

## Equilibrium in Monopoly

The conditions for Equilibrium in Monopoly are the same as those under perfect competition. The marginal cost (MC) is equal to the marginal revenue (MR) and the MC curve cuts the MR curve from below. In this article, we will understand Equilibrium in Monopoly in detail.

## A Firm's Short-Run Equilibrium in Monopoly

Like in perfect competition, there are three possibilities for a firm's Equilibrium in Monopoly. These are:



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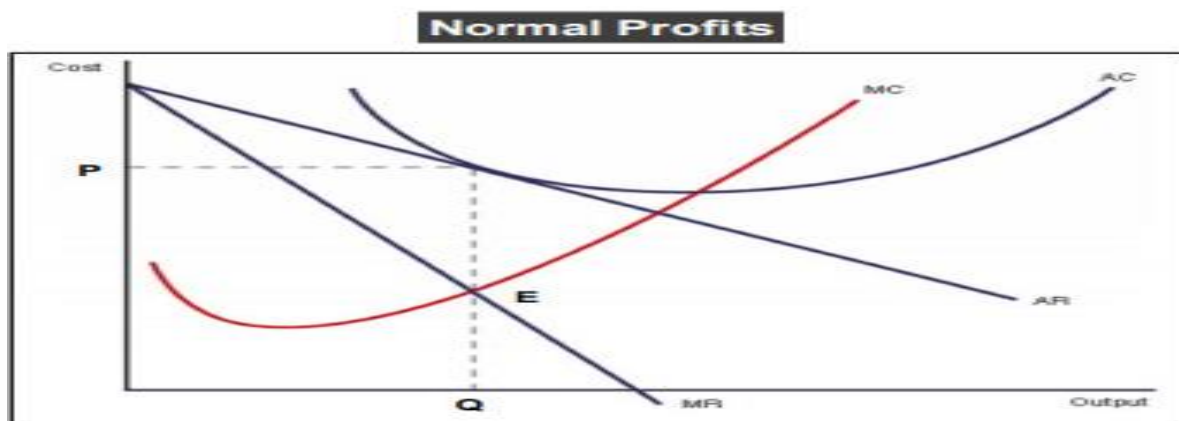
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1. The firm earns normal profits – If the average cost = the average revenue
2. It earns super-normal profits – If the average cost < the average revenue
3. It incurs losses – If the average cost > the average revenue

## Normal Profits

A firm earns normal profits when the average cost of production is equal to the average revenue for the corresponding output.



In the figure above, you can see that the MC curve cuts the MR curve at the equilibrium point E. Also, the AC curve touches the AR curve at a point corresponding to the same point. Therefore, the firm earns normal profits.

## Super-normal Profits

A firm earns super-normal profits when the average cost of production is less than the average revenue for the corresponding output.



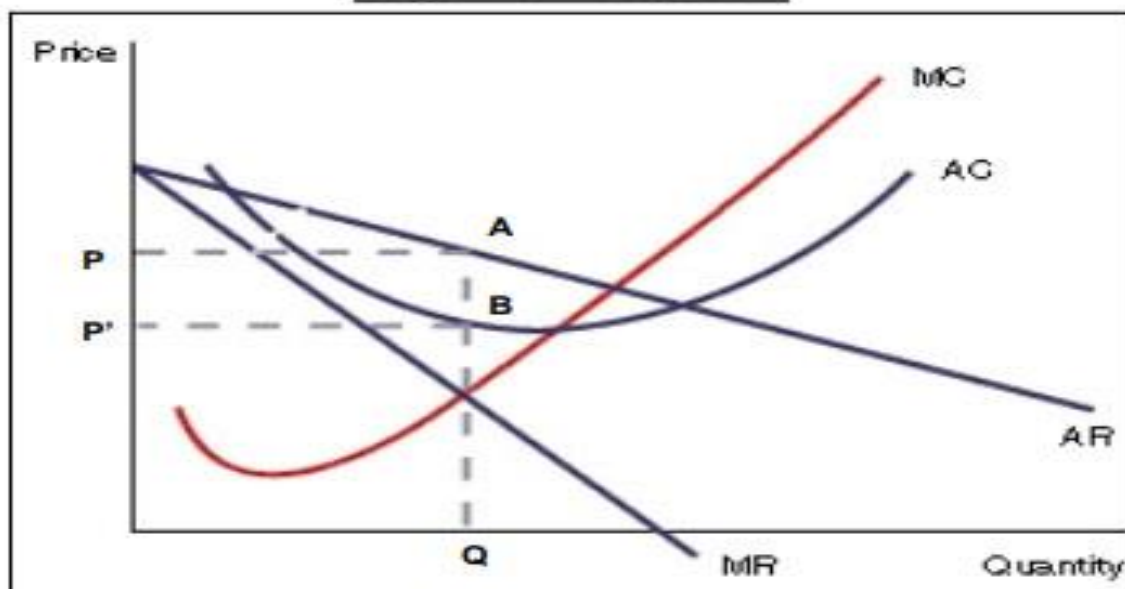
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## Supernormal profit



In the figure above, you can see that the price per unit =  $OP = QA$ . Also, the cost per unit =  $OP'$ . Therefore, the firm is earning more and incurring a lesser cost. In this case, the per unit profit is

$$OP - OP' = PP'$$

In addition, the total profit earned by the monopolist is  $PP'BA$ .

### Losses

A firm earns losses when the average cost of production is higher than the average revenue for the corresponding output.

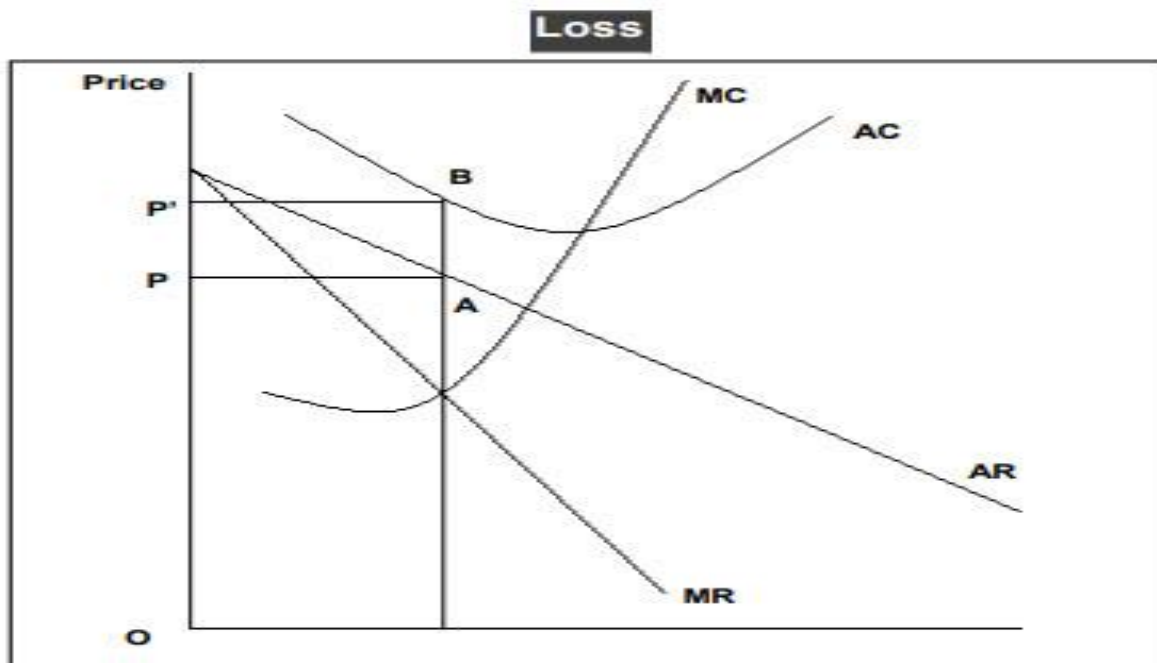


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In the figure above, you can see that the average cost curve lies above the average revenue curve for the same quantity. The average revenue =  $OP$  and the average cost =  $OP'$ . Therefore, the firm is incurring an average loss of  $PP'$  and the total loss is  $PP'BA$ . In the short-run, a monopolist sometimes sets a lower price and incurs losses to keep new firms away.

## Summary of Short-run Equilibrium in Monopoly

In the short-run, a monopolist firm cannot vary all its factors of production as its cost curves are similar to a firm operating in perfect competition. Also, in the short-run, a monopolist might incur losses but will shut down only if the losses exceed its fixed costs. Further, if the demand for his product is high, then the monopolist can also make super-normal profits.

## A Firm's Long-run Equilibrium in Monopoly

In the long-run, a monopolist can vary all the inputs. Therefore, to determine the equilibrium of the firm, we need only two cost curves – the AC and the MC. Further,



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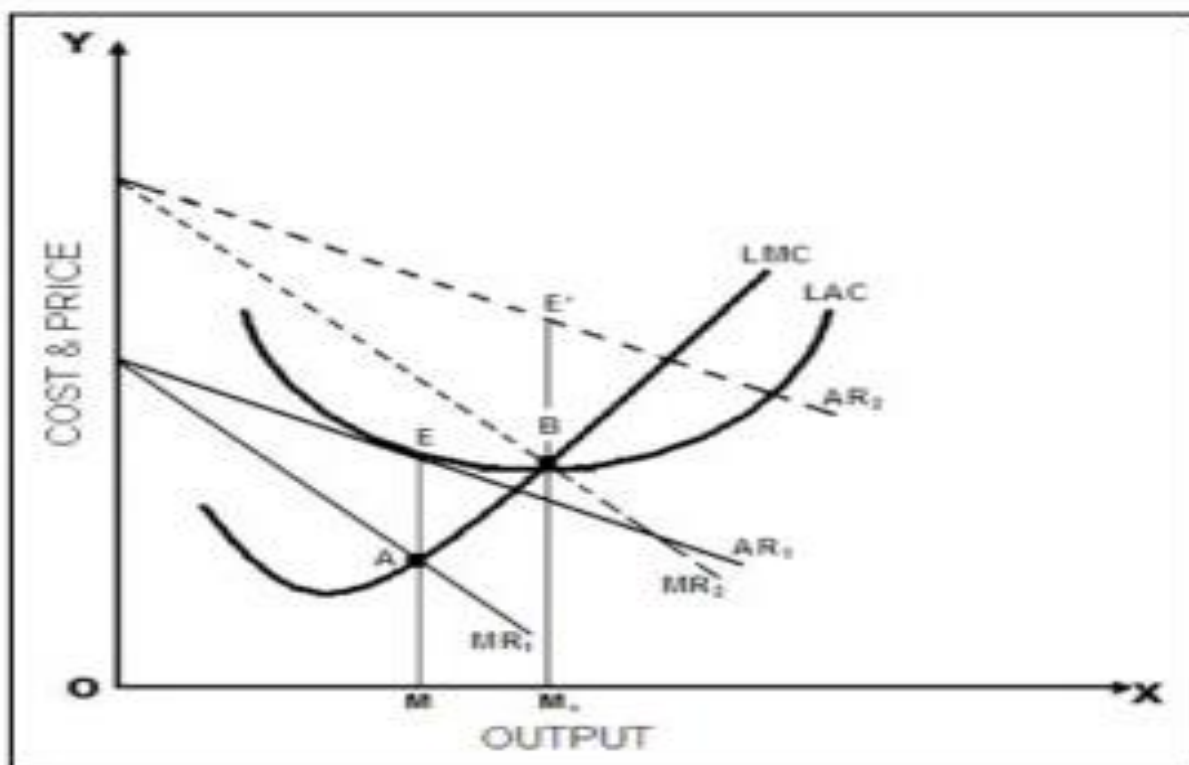
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since the monopolist exits the market if he is operating at a loss, the demand curve must be tangent to the AC curve or lie to the right and intersect it twice.

### Long Run Equilibrium of a Monopolist



As you can see above, there are two alternative cases for the determination of Equilibrium in Monopoly:

- With normal profits
- With super-normal profits

We have not taken the loss scenario here because if the monopolist incurs losses in the long-run, he will stop operating.





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## Case 1

The demand curve  $AR_1$  is tangent to AC or LAC at point E. Remember, if the demand curve lies to the left of the AC curve, then the monopolist is unable to recover his costs and closes down.

However, if the AR curve is tangent to the AC curve, then the monopolist can recover his costs and stay in the market.

Further, note that the perpendicular drawn from point E to the X-axis, the MC curve, and the MR curve are concurrent at point A.

Therefore, all the conditions of equilibrium are satisfied. The monopolist produces OM quantity and sells it at a price of EM per unit, which covers its average costs + normal profits.

## Case 2

The marginal revenue curve  $MR_2$  cuts the MC curve from below at point B. The corresponding height of the AR2 curve is  $E'M_1$ .

Hence, the monopolist produces  $OM_1$  quantity and sells it at  $E'M_1$  per unit to earn an extra profit of  $E'B$  per unit. Being a monopoly, this extra profit is not lost to competition or newer firms entering the industry.

## Monopolistic Competition

The perfect competition and monopoly are the two extreme forms. To bridge the gap the concept of monopolistic competition was developed by Edward Chamberlin. It has both the elements like many small sellers and many small buyers. There is product differentiation. Therefore close substitutes are available and at the same time it is easy to enter and easy to exit from the market. Therefore, it is possible to incur loss in this market. The profit maximization for each firm, for each product depends upon the differentiation and advertising expenditure. As every firm is acting as a monopoly, the same logic of monopoly is followed. Each firm will have their own set of cost and revenue curves and the price



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determination is based on the rule of  $MR=MC$  and they incur varied profits according to their market structure. However, in the monopolistic competition number of monopoly competitors will be there in different levels. They monopolize in a small geographical area, a segment, or a model.

## Characteristic of Monopolistic Competition:

- 1. Large Number of Firms:** Under monopolistic competition, the number of firms is large. Large number is suggestive of the fact that the contribution of an individual firm with regard to the total demand for the commodity is not very significant. Because of product differentiation, each firm follows, to some extent, independent price-output policy. Each seller shares only a small part of the market supply. Given these features, no single seller can influence the market price by changing his supply. Therefore, seller is a price-taker.
- 2. Number of Buyers:** The number of buyers is very large, so large that no single buyer, by his individual or collective action with other buyers, can influence market price by changing demand. This is because the demand of a single buyer is a very small part of the total demand in the market. The analogy of an atom can be used to indicate this share. Hence, it is beyond the power of a single buyer to influence market price. Consequently, he has to accept the market price as given and adjust his demand to it. The buyer is a price-taker in this market.
- 3. Product Differentiation:** Under Monopolistic competition, the products of different sellers are differentiated on the basis of brands. These brands are generally so much advertised that a consumer starts associating the brand with a particular manufacture and type of brand loyalty is developed. Product differentiation gives rise to an element of monopoly to the producer over the competing product. As such, the producer of an individual brand can raise the price of his product knowing that he will not lose all the customers to other brands because of absence of perfect substitutability. Since, however, all the brands are close substitutes of one another, the seller will lose some of his customers to his competitors. Thus, this market is a blend of monopoly and perfect competition.



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4. **Knowledge of Market:** Both the buyers and sellers have imperfect knowledge of the market because of attachment to the specific brands and to the specific sellers. Buyers do not bother to know about the substitute brands as well as other sellers even next door.
5. **Non-price competition:** In this market, sellers try to compete based on other than price, as for example aggressive advertisement, product development, better distribution arrangements, efficient after-sales service, and so on. A key base of non-price competition is a deliberate policy of product differentiation. Sellers attempt to promote their products not by cutting prices but by incurring high expenditure on publicity and advertisement and other sales promoting techniques mentioned above.
6. **Freedom for Entry and Exit:** The firms can easily enter or leave the monopolistically competitive industry without any entrance or leave the monopolistically competitive industry without any difficulty in the long run.
7. **Slope of Demand Curve:** Under monopolistic competition, because of product differentiation, the seller has some degree of control over the price he charges and thus faces a negatively sloped demand curve. However, the existence of many close substitutes severely limits the sellers' 'monopoly' power and results in a highly

## Equilibrium under Monopolistic Competition

Before determining a firm's equilibrium under Monopolistic Competition, it is important to note that there are two possible demand curves – both sloping downwards. In this article, we will look at a firm's short-run and long run equilibrium under Monopolistic Competition.

The two types of demand curves of a firm under monopolistic competition are due to the following reasons:

- When a firm revises the price of its product, the rival firms do not always increase the prices of their products too. Therefore, the demand curve has a smaller slope and the demand for the product is more elastic.



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- If the rival firms follow the price revision by the first firm, then the demand for its product becomes less elastic. In such cases, the firm needs to slash its prices further to achieve an increase in demand. In this case, the demand curve has a steeper slope.

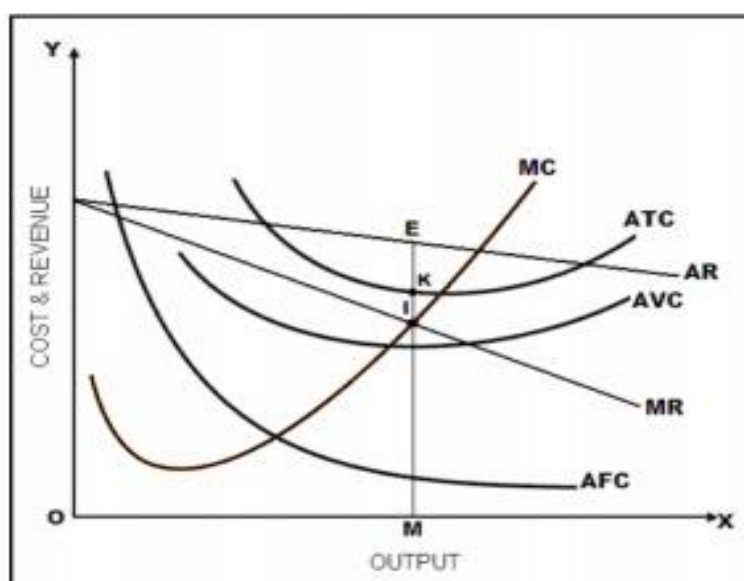
## A Firm's Short-Run Equilibrium under Monopolistic Competition

Under Monopolistic Competition, the revenue curves are downward sloping (like under Monopoly). This is because, in order to sell more, the firm has to decrease the price.

A firm under Monopolistic Competition can either earn normal profits, super-normal profits, or incur losses. In addition, like under Monopoly, a firm earns super-normal profits if the demand for its product is very high.

In addition, in the short-run, new firms cannot enter the group and enhance the supply of the product group. Therefore, they cannot compete away the super-normal profits of the firm. In addition, in the short-run, a firm faces certain fixed costs. These can include production as well as selling costs.

### Short Run Equilibrium under Monopolistic Competition





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In the figure above, you can see that the AR and MR curves of the firm have negative slopes. Further, the AVC curve includes the production costs as well as the variable components of selling expenses. Furthermore.

The MC curve cuts the AVC curve at its lowest point. In addition, the ATC curve represents the average of the total cost of the firm including the fixed selling expenses.

The MC curve intersects the MR curve from below at point I. Hence, the firm decides to produce a quantity of OM and charge a price of EM per unit.

By doing so, the firm earns a profit of EK per unit and the entry of rival firms do not compete it out. However, based on the relative location of the cost and revenue curves, it is possible that the firm is in equilibrium with:

- Only normal profit
- Covering a part of fixed costs. Therefore, incurring a loss less than its fixed costs
- Loss equal to the fixed costs (where AR is tangent to the AVC curve)

### **A Firm's Long-Run Equilibrium under Monopolistic Competition**

To discuss a firm's long-run equilibrium under Monopolistic Competition, it is important to remember the following points:

- There are no fixed costs in the long run. The firm can vary its inputs as well as its selling costs. Further, the firm can choose between various product qualities.
- There is no compulsion on a firm to operate at a loss. It can leave the industry whenever it wants. When a firm leaves the industry, the absolute market shares of the remaining firms, increase. Further, their demand curve shifts right and upwards. This continues until other firms can produce without incurring a loss.



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- On the other hand, if the demand is so strong that the existing firms make super-normal profits, then new firms can enter the group.
- They produce close substitutes of the existing products and increase the total product supply. Therefore, the demand shares of the existing firms reduce. Hence, the demand curve of a firm cannot stay above its long-run average cost curve.
- All firms operating under Monopolistic Competition can make a choice between combinations of:
  - Product quality
  - Product Differentiation
  - Selling costs
- A firm must consider the fact that any variation of price on its part can attract a reaction from its rivals. Therefore, it faces a much steeper demand curve.

Therefore, under Monopolistic Competition, a firm is exposed to constant interaction with the rest of the firms in the group. Its decisions are not independent of the decisions of the other firms.

Further, the firm's demand curve depends on its actions AS WELL AS on the actions of its rivals. Therefore, it must consider different combinations of its cost components pertaining to the product quality and its selling expenses, etc. This helps the firm estimate the slope and position of the demand curve.

### **Oligopoly :**

Oligopoly is an important form of imperfect competition. Oligopoly is often described as 'competition among the few'. In other words, when there are few (two to ten) sellers in a market selling homogeneous or differentiated products, oligopoly is said to exist. Consider the example of cold drinks industry, automobile industry, chemical industry, oil refinery, fertilizers, the market is oligopolistic one.

The oligopoly market is classified into following groups-





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**a) Pure and differentiated Oligopoly:** If the oligopoly product is homogeneous, it is called as a pure oligopoly. When the product is differentiated, then it is called as differentiated oligopoly.

**b) Collusive and Non-Collusive Oligopoly:** If the oligopolists join and take care their business decisions collectively, it is called as a collusive oligopoly. In a non-collusive oligopoly, the business decisions are taken independently.

**c) Oligopoly with price leadership:** If the firms in an oligopoly market follow the pricing decision of their leader, it becomes oligopoly with price leadership. The leader firm may be a dominant firm or old firm or firm with lowest cost.

### Characteristic features of Oligopoly:

Oligopoly market has following important features.

- 1. Interdependence:** The most important feature of oligopoly is interdependence indecision-making of the few firms, which comprise the industry. This is because when the number of competitors is few, any change in price, output, product, by a firm will have direct effect on the fortune of the rivals, who will then retaliate in changing their own prices, output or advertising technique as the case may be. It is therefore, clear that an oligopolistic firm must consider not only the market demand or the industry product but also the reactions of other firms in the industry to any major decision it takes.
- 2. Importance of selling cost:** Under oligopoly, the advertisement can become a life and death matter. In order to maintain the market share every firm uses advertisement as an effective weapon. For this various firms have to incur a good deal of costs on advertising and other measures of sales promotion.
- 3. Group behaviour:** Under oligopoly, the firm's behaviour cannot be explained merely by profit maximization behaviour. It requires the study of group behaviour. The firms may form a collusion or may fight a price war. Do the members of group agree to pull together in promotion of



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common interest or will they fight to promote their individual interests? Does the group possess any leader? If so, how does he get the other to follow him? These are some of the questions that need to be answered by the business behaviour.

4. **Number of Sellers:** There exist few sellers in this market. Such cases do exist in large numbers in all the countries. In India, think of the petroleum, cooking gas, telephone, cellular phone, iron and steel, automobile, tyres, refrigerator, cement etc., industries in which we come across limited number of sellers.
5. **Number of Buyers:** The number of buyers is very large, so large that no single buyer, by his individual or collective action with other buyers, can influence market price by changing demand. This is because the demand of a single buyer is a very small part of the total demand in the market. Consequently, he has to accept the market price as given and adjust his demand to it. The buyer is a 'price-taker' in this market
6. **Nature of the Product: In this context, there are two possibilities.**
  - a) **Homogeneous product:** All the sellers may be selling identical products and, therefore, price assumes importance. Product like petrol, diesel, kerosene, cooking gas, iron and steel, aluminium, cement fall into this category. Market of this kind is described as 'pure oligopoly'.
  - b) **Differentiated product:** Oligopolists have the choice of following product differentiation. Cellular telephones, tyres, refrigerators, detergent soaps, soft drinks automobile etc. fall into this category. Every seller enjoys a limited monopoly power in the market. Market of this kind is described as 'differentiated oligopoly'.
7. **Barriers to Entry :**

In oligopolistic industry, obstacles to entry are formidable. Entry of new firms is prevented by ownership of crucial patents or ownership of vital raw materials. Many times technological conditions are such that production is economic only on a large scale. A new firm therefore will have to start production on a large scale from the very outset. It is not possible to make a modest beginning and expanding gradually as the firm is established. As such, the scale of production also may make entry of a



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new firm difficult. In addition, the existing firms enjoy advantages such as reputation of their brand names, long established distribution channels, good will of the customers etc., and any new firm desirous of entering the field will have to consider these factors, which make entry difficult.

### 8. Demand curve :

It is not easy to trace the demand curve for the product of an oligopolistic. Since under oligopoly the exact behaviour pattern of a producer cannot be ascertained, his demand curve cannot be drawn accurately, and with definiteness. How does an individual seller's demand curve look like in oligopoly is most uncertain because a seller's price or output moves leads to unpredictable reactions on price-output policies of his rivals, which may have further repercussions on his price and output.

### Oligopoly – Kinked Demand Curve

#### **What is the kinked demand curve model of oligopoly?**

The **kinked demand curve** model assumes that a business might face a **dual demand curve** for its product based on the **likely reactions of other firms** to a change in its price or another variable

The kinky demand curve model tries to explain that in non-collusive oligopolistic industries there are not frequent changes in the market prices of the products. The demand curve is drawn on the assumption that the kink in the curve is always at the ruling price. The reason is that a firm in the market supplies a significant share of the product and has a powerful influence in the prevailing price of the commodity. Under oligopoly, a firm has two choices:

- (a) The first choice is that the firm increases the price of the product. Each firm in the industry is fully aware of the fact that if it increases the price of the product, it will lose most of its customers to its rival. In such a case, the upper part of demand curve is more elastic than the part of the curve lying below the kink.
- (b) The second option for the firm is to decrease the price. In case the firm lowers the price, its total sales will increase, but it cannot push up its sales very much because the rival firms also follow suit with a price cut. If the rival firms make larger price cut than the one, which initiated it, the firm, which first started the price cut, will suffer a lot and may finish up with



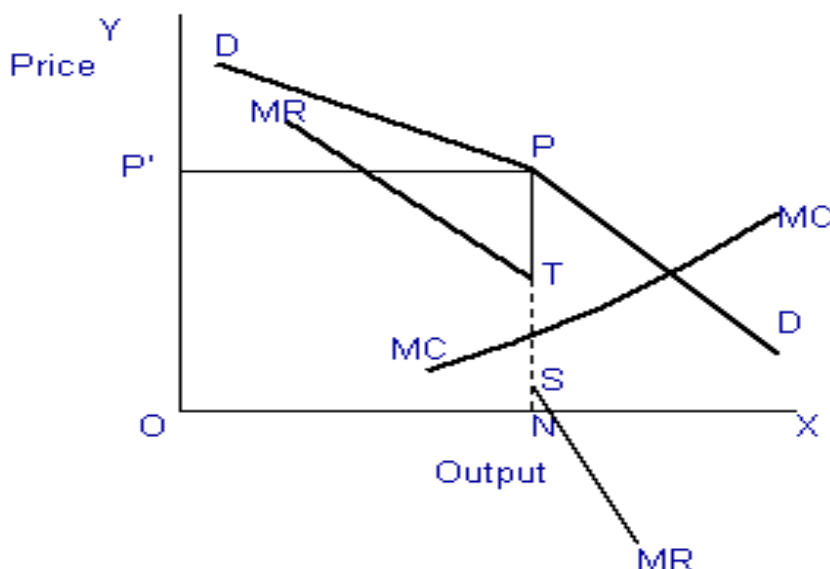
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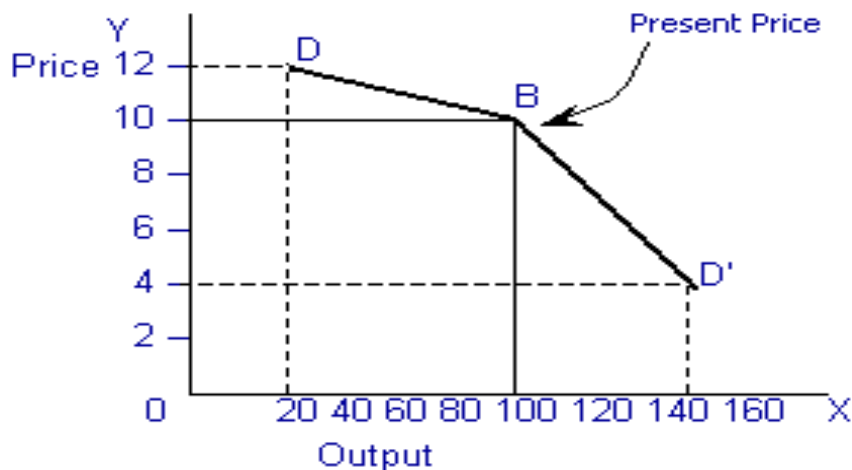
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decreased sales. The oligopolists, therefore avoid cutting price, and try to sell their products at the prevailing market price. These firms, however, compete with one another based on quality, product design, after-sales services, advertising, discounts, gifts, warranties, special offers, etc.



In the above diagram, we shall notice that there is a discontinuity in the marginal revenue curve just below the point corresponding to the kink. During this discontinuity the marginal cost curve is drawn. This is because of the fact that the firm is in equilibrium at output ON where the MC curve is intersecting the MR curve from below.

The kinked demand curve is further explained in the following diagram





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In the above diagram, the demand curve is made up of two segments DB and BD'. The demand curve is kinked at point B. When the price is Rs. 10 per unit, a firm sells 120 units of output. If a firm decides to charge Rs. 12 per unit, it loses a large part of the market and its sales come down to 40 units with a loss of 80 units. In case, the producer lowers the price to Rs. 4 per unit, its competitors in the industry will match the price cut. Its sales with a big price cut of Rs. 6 increases the sale by only 40 units. The firm does not gain as its total revenue decreases with the price cut.



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# Principles of Marketing

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### UNIT 1: INTRODUCTION TO MODERN MARKETING

#### **INTRODUCTION:**

- Marketing has become the biggest buzzword now-a-days Liberalization and privatization coupled with globalization turned the world into a "global village".
- In the era of fierce competition, mushrooming of brands, shortening of brand life cycles, dynamic marketing environment, superfast technological innovations and knowledge explosion have undoubtedly created a need for systematic and aggressive marketing.
- Today all marketers have realized the fact that any idea, concept, product or services cannot stand without the strong support of marketing. As organizational excellence largely depends upon the judiciously designed marketing strategy, it must play a pivotal role in the modern organizations.
- The cases of marketing juggernauts like PEPSI, HUL, P&G, COCA COLA, NOKIA and many more are proven illustrations of sound market standing by vigorous marketing exercises.

#### **EVOLUTION OF MARKETING CONCEPTS**

- Marketing philosophies or concepts are set of presumptions held by marketing managers in executing marketing strategies and programs.
- It is also called as stages in which marketing as a -concept" has grown. Marketing is a discipline which comes from practice. It is also called as viable match between situation and strategy.
- Hence from past to the present, marketing has to pass through the test of various situations and from this, various concepts are evolved.

#### **(1) The Production Concept:**

- "The production concept believes that consumer prefers those products which are largely available and reasonably priced". The concept focuses on following aspects:

- (1) Consumers buy those products which are easily and widely available.
- (2) Consumers are price conscious products.



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- (3) The concept is relevant when demand exceeds supply.
- (4) Product cost may be high and it has to be lowered down by increasing productivity and maximizing output.

**Production concept**



**consumer prefers those products which are largely available and reasonably priced**

### (2) The Product Concept:

- Production Concept loses its relevance when market is moving from commodities to products and to brands. Due to some of the major changes in the market and environment like awareness of Consumers, varieties of products, awareness regarding quality, increase in research potential etc. gave birth to the product concept.
- According to this concept, "Consumers gradually become quality conscious and they prefer to buy those products which are best in quality and superior in performance.
- Thus, prime focus of managers is on the research, up gradation and innovation in the products". The managers holding this philosophy believes that product is most important competitive weapon in deciding market share of the company.
- So, if company wants, to survive, it has to give due importance to the product improvement and quality enhancement. According to this approach, consumers seek products that are technically and functionally competent and demonstrate better performance than competitors.

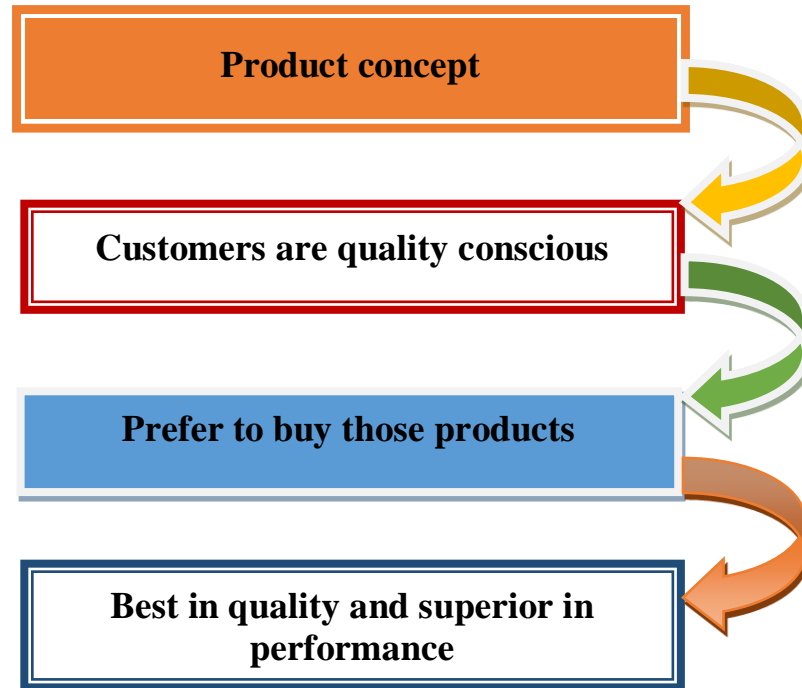


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### (3) The Selling Concept:

- Due to emergence of some of the environmental factors and trends like,
- Increasing consumer awareness and education.
- Emergence of media and advertising tools.
- Introduction of selling techniques and promotional tools.

There is evolution of selling concept "The selling concept believes that consumers are to be stimulated to buy products by selling and promotional effects.

- The concept assumes that, consumers are unaware of the product. They need to be stimulated and motivated to buy products. Organization must undertake hard-selling efforts to create sales. When seller's market is converted into buyer's market, this concept is useful.
- In a nutshell, selling concept states aggressive selling and promotional efforts to achieve desired sales target and volume. The selling concept has injected great push to selling and it is major element of marketing, but it misses the core element of marketing process i.e. consumers.



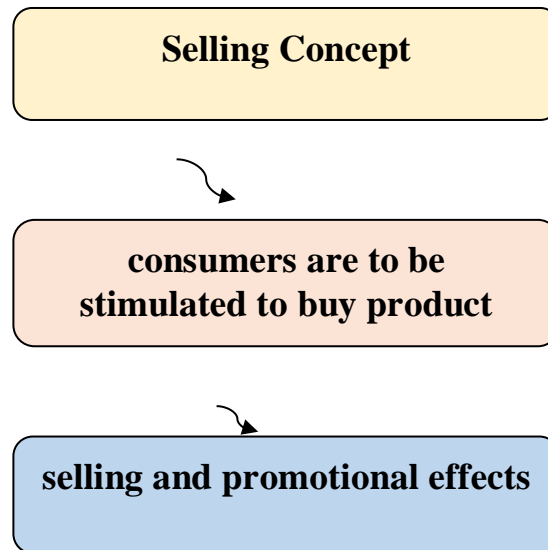
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- The concept only focuses on seller's perception and ignores consumer's needs and wants, as noted by Philip Kotler. The concept believes in "Try to sell what we can make instead of trying to make what we can sell."



#### (4) The Marketing Concept and Societal Concept:

- "The marketing concept believes that company / organization should identify Consumer needs and wants and try to fulfill those needs. It should match products and services with market requirement to create satisfied Consumer base."
- In the words of Philip Kotler, "The marketing concept holds that the key to achieve organizational goals consists in determining the needs and wants of target market and delivering desired satisfaction more effectively and efficiently than competitors."
- Analysis of the concept reveals following crucial elements
  - (1) Consumer satisfaction is a focal point in business.
  - (2) Know your customers and find their needs.
  - (3) Focus on the specific target market.
  - (4) Offer superior products and services than your competitors.
  - (5) Profit is just outcome of consumer satisfaction.

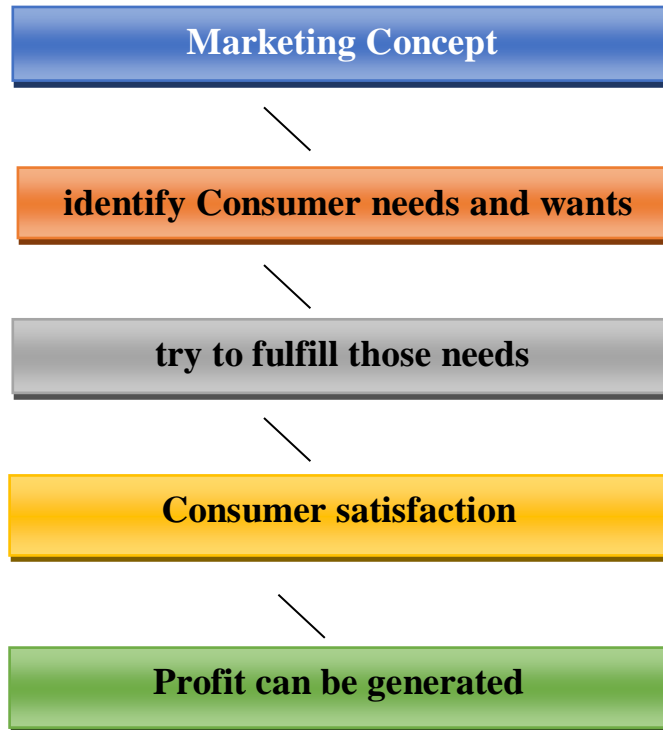


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- Challenges of the market made marketers- aware and conscious about the changes required in marketing strategy.
- For example, Bajaj Auto has changed its focus from Scooters to Motorbikes as target. Market's preferences are switching over to latter product. US food chains like McDonalds and Pizza Hut are also Indianizing their recipes.
- The modern marketing starts and ends with consumer. According to the concept, it is very comprehensive process which includes study of market exploiting market opportunities, select market segment, designs suitable product and services, promote them and delivering them to customers.
- The Crux of the entire process is to serve target market in more superior, efficient and faster than competitors. It is a key to unlock hidden needs of customers.

### **1 WORD QUESTION ANSWER**



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<u>SR.NO</u>	<u>QUESTION</u>	<u>ANSWER</u>
1	_____ has become the biggest buzzword now-a-days	Marketing
2	Liberalization and privatization coupled with globalization turned the world into what?	"global village"
3	Today all marketers have realized the fact that any idea, concept, product or services cannot stand without _____	the strong support of marketing.
4	It must play a pivotal role in the modern organizations	Marketing strategy
5	_____ are set of presumptions held by marketing managers in executing marketing strategies and programs.	Marketing philosophies or concepts
6	It is also called as stages in which marketing as a - concept" has grown.	Marketing philosophies or concepts
7	_____ concept believes that consumer prefers those products which are largely available and reasonably priced.	The production concept
8	According to this concept, Consumers buy those products which are easily and widely available.	The production concept
9	According to this concept, Consumers are price conscious for purchase products.	The production concept
10	This concept is relevant when demand exceeds supply.	The production concept
11	According to this concept, "Consumers gradually become quality conscious and they prefer to buy those products which are best in quality and superior in performance.	The Product Concept
12	The managers holding this philosophy believes that ____ is most important competitive weapon in deciding market share of the company.	product





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13	This concept believes that consumers seek products that are technically and functionally competent and demonstrate better performance than competitors.	The product concept
14	The _____ believes that consumers are to be stimulated to buy products by selling and promotional effects.	selling concept
15	Which concept assume that consumers are unaware of the product. They need to be stimulated and motivated to buy products.	The selling concept
16	When seller's market is converted into buyer's market, at that time which concept is useful.	The selling concept
17	The selling concept only focuses on seller's perception and ignores consumer's needs and wants, as noted by whom?	Philip Kotler
18	"Try to sell what we can make instead of trying to make what we can sell."-this statement concentrate on which concept?	The selling concept
19	"_____concept believes that company / organization should identify Consumer needs and wants and try to fulfill those needs.	The marketing concept
20	Consumer satisfaction is a focal point in business & profit is outcome of satisfaction believes in this concept.	Marketing & selling concept

### DIFFERENCES BETWEEN SELLING CONCEPT, MARKETING CONCEPT AND SOCIETAL CONCEPT

Particulars	Marketing	Selling
Concept	It is a strategy based on a mix of activities that are aimed at increasing the sales.	It is the strategy of meeting the needs in an opportunistic, individual method, driven by human interaction.



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<b>Focus</b>	<ul style="list-style-type: none"> <li>It <b>targets</b> the construction of a <b>brand identity</b>, needs of the consumers and how to reach to the consumers.</li> <li>It starts with the buyers and <b>focuses</b> constantly on the <b>buyer's needs</b>.</li> </ul>	<ul style="list-style-type: none"> <li>It is the final act of buying goods or products by the consumers through a <b>point sale</b>.</li> <li>It starts with the seller and is <b>focused with the seller's needs</b>.</li> </ul>
<b>Efforts</b>	It makes an effort such that the customers actually want to buy the products in their own interest.	The company makes the product first and then figures a way to sell and make profit.
<b>Business</b>	A customer satisfying process.	Actual sales of goods.
<b>Cost</b>	The consumers determine the price; the price determines the cost.	Cost determines the price.
<b>Motive</b>	Customer satisfaction is the primary motive.	Sales are the primary motives.
<b>Orientation</b>	External market orientation.	Internal production orientation.
<b>Perspective</b>	It takes an outside-in perspective.	It takes an inside-out perspective.
<b>Concept</b>	It is a broad, composite and worldwide concept.	It is a narrow concept related to buyer, seller and production.
<b>Strategy</b>	It has a 'pull' strategy.	It has a 'push' strategy.
<b>Beginning</b>	It begins much before production of goods and services.	It comes after production and ends with delivery and collection of payment.
<b>Scope</b>	It has a wider connotation and includes many research activities.	It is a part of marketing.
<b>Concern</b>	It concerns with customer satisfaction.	It concerns with value satisfaction.
<b>Structure</b>	It is an organizational structure.	It is a functional structure.
<b>Job</b>	The main job is to find the right products for the customers.	The main job is to find the customers for the products.
<b>Mindset</b>	The mindset is "Satisfy the customers".	The mindset is "Hook the customers".



# SHREE H.N.SHUKLACOLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## NATURE OF MODERN MARKETING

(1) It is a human activity and it involves interaction between two social units. Marketing is basically a social process, in which marketers offer goods and services to consumers. As it involves human factor, which attempts to analyze consumer behavior and psychological and social aspects influencing consumption pattern and process.

(2) It deals with sensing needs of market and converts them into profitable market opportunities. Marketers always explore new markets having great market potential. It focuses on sensing latent needs of the market and try to fulfill those needs and wants. For example, "Sugar free" was initially designed and developed to satisfy needs of diabetic patients and then it attempted to expand demand.

(3) It involves exchange process: Marketing can be successful only when the entire process results into fruitful exchange. It is a process of offering something to other party and getting something in return from other.

(4) It is a comprehensive and managerial process which involves various marketing activities like

- (1) Determining target market.
- (2) Formulating marketing strategy including designing product, setting price, promoting product and ultimately delivering products to the end users.

### 1 WORD QUESTION ANSWER

<u>SR.NO</u>	<u>QUESTION</u>	<u>ANSWER</u>
1	It is a human activity and it involves interaction between two social units.	Modern marketing
2	Marketing is also called _____	Exchange process
3	Marketing is deals with whom??	Customer needs & convert into profitable channel



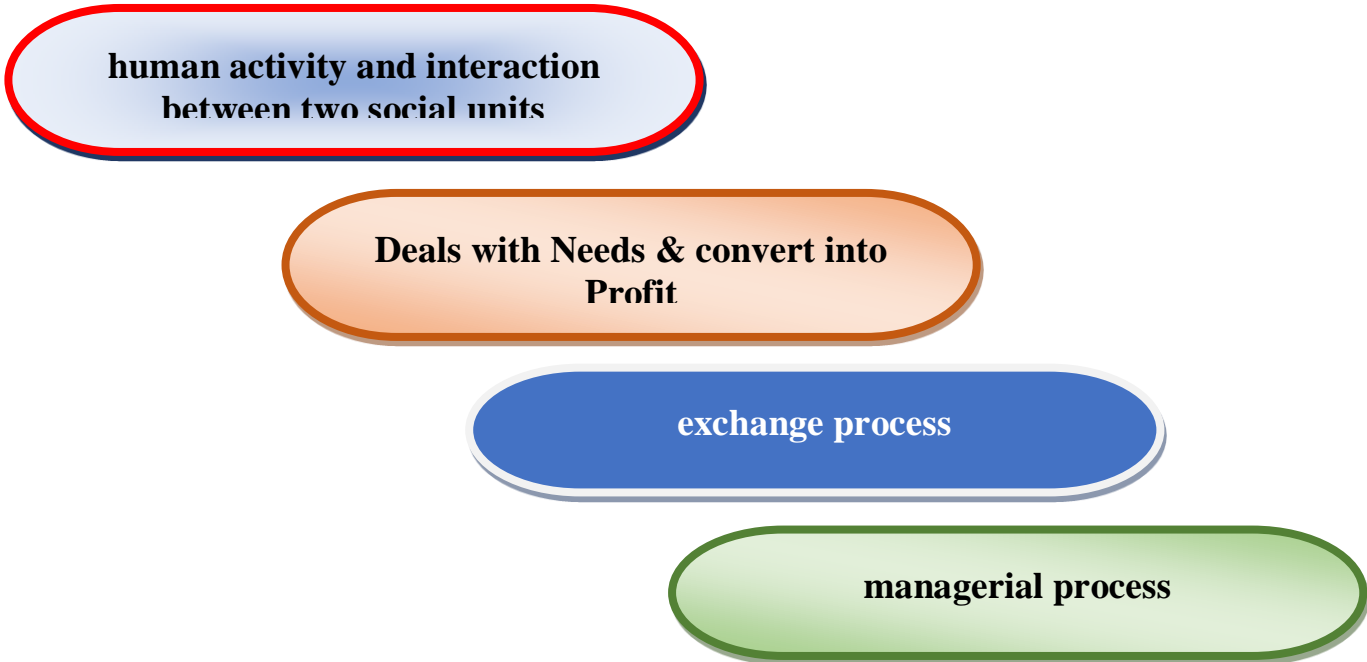
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 Ph. No–(0281)2471645

2 – Vaishalinagar  
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 Ph.No–(0281)2440478, 2472590

4	Marketing involves various marketing activities like _____	<ul style="list-style-type: none"> <li>• Determining target market</li> <li>• Formulating marketing strategy</li> </ul>
5	It is a process of offering something to other party and getting something in return from other.	Marketing as an exchange process



## IMPORTANCE OF MARKETING

### (1) Marketing Helps in Transfer, Exchange and Movement of Goods:

- Marketing is very helpful in transfer, exchange and movement of goods. Goods and services are made available to customers through various intermediaries' viz., wholesalers and retailers etc. Marketing is helpful to both producers and consumers.
- To the former, it tells about the specific needs and preferences of consumers and to the latter about the products that manufacturers can offer. According to Prof. Haney Hansen



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“Marketing involves the design of the products acceptable to the consumers and the conduct of those activities which facilitate the transfer of ownership between seller and buyer.”

### **(2) Marketing Is Helpful in Raising and Maintaining the Standard of Living of the Community:**

- Marketing is above all the giving of a standard of living to the community. Paul Mazur states, “Marketing is the delivery of standard of living”.
- Professor Malcolm McNair has further added that “Marketing is the creation and delivery of standard of living to the society”.

### **(3) Marketing Creates Employment:**

- Marketing is complex mechanism involving many people in one form or the other.
- The major marketing functions are buying, selling, financing, transport, warehousing, risk bearing and standardization, etc. In each such function different activities are performed by a large number of individuals and bodies.

### **(4) Marketing as a Source of Income and Revenue:**

- The performance of marketing function is all important, because it is the only way through which the concern could generate revenue or income and bring in profits.
- Buskirk has pointed out that, “Any activity connected with obtaining income is a marketing action. It is all too easy for the accountant, engineer, etc., to operate under the broad assumption that the Company will realize many dollars in total sales volume.

### **(5) Marketing Acts as a Basis for Making Decisions:**

- A businessman is confronted with many problems in the form of what, how, when, how much and for whom to produce? In the past problems was less on account of local markets.
- There was a direct link between producer and consumer. In modern times marketing has become a very complex and tedious task.



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- Marketing has emerged as new specialized activity along with production. As a result, producers are depending largely on the mechanism of marketing, to decide what to produce and sell. With the help of marketing techniques, a producer can regulate his production accordingly.

### (6) Marketing Acts as a Source of New Ideas:

- The concept of marketing is a dynamic concept. It has changed altogether with the passage of time. Such changes have far reaching effects on production and distribution.
- With the rapid change in tastes and preference of people, marketing has to come up with the same.
- Marketing as an instrument of measurement, gives scope for understanding this new demand pattern and thereby produce and make available the goods accordingly.

### (7) Marketing Is Helpful in Development of an Economy:

- Adam Smith has remarked that “nothing happens in our country until somebody sells something”. Marketing is the kingpin that sets the economy revolving.
- The marketing organization, more scientifically organized, makes the economy strong and stable, the lesser the stress on the marketing function, the weaker will be the economy.

### 1 WORD QUESTION ANSWER

<u>SR.NO</u>	<u>QUESTION</u>	<u>ANSWER</u>
1	It Helps in Transfer, Exchange and Movement of Goods	Marketing
2	Marketing Is Helpful in_____	Raising and Maintaining the Standard of Living of the Community



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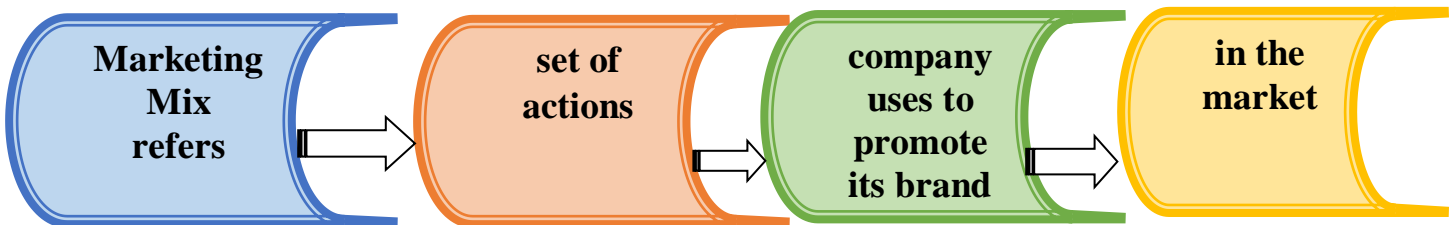
3	Marketing also helps in _____	Creates Employment
4	The concept of marketing is a ____ concept	dynamic
5	Marketing Is Helpful in _____	Development of an Economy
6	Marketing as a Source of _____	Income and Revenue

## MARKETING MIX (4P'S)

- Marketing Mix - A mixture of several ideas and plans followed by a marketing representative to promote a product or brand is called marketing mix.
- Several concepts and ideas combined to formulate final strategies helpful in making a brand popular amongst the masses form marketing mix.

### Definition:

- The marketing mix refers to the set of actions, or tactics, that a company uses to promote its brand or product in the market.
- The 4Ps make up a typical marketing mix - Price, Product, Promotion and Place. However, nowadays, the marketing mix increasingly includes several other Ps like Packaging, Positioning, People and even Politics as vital mix elements.



### Elements of Marketing Mix:





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## 1.Product:

- It is a tangible good or an intangible service that is mass produced or manufactured on a large scale with a specific volume of units.
- Intangible products are service based like the tourism industry & the hotel industry or codes-based products like cell phone load and credits. Typical examples of a mass-produced tangible object are the motor car and the disposable razor.
- A less obvious but ubiquitous mass-produced service is a computer operating system. Packaging also needs to be taken into consideration. Every product is subject to a life-cycle including a growth phase followed by an eventual period of decline as the product approaches market saturation.
- To retain its competitiveness in the market, product differentiation is required and is one of the strategies to differentiate a product from its competitors.

## 2.Price Mix:

Price is economic value of a product denominated in terms of money. It is also significant weapon to capture market; especially Indian market is highly price sensitive.

For example, McDonald, the leading food chain of U.S., has offered happy price menu to Indian consumers. The decision of pricing includes following crucial elements

1. Methods of pricing.
2. Which factors to be considered while designing pricing strategies. For example, level of demand, cost, competition or customer's preparation.
3. Other elements of pricing like discounts, allowances, credit terms etc.

## 3. Promotion Mix

- After designing product and setting price for the same, the next stage is to decide about how to plan promotion strategy to create awareness, persuade and convince consumer by highlighting powerful selling points by using various promotional tools. It includes following elements:

### (1) Advertising:



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- Advertising, being heavily used tool for communication and promotion, includes, basic five elements i.e. motive for advertising, media decision, advertising budget, message designing and measuring advertising effectiveness.

### (2) Personal Selling:

- Personal selling activity is relevant in case of using zero level channel company. Company may directly sell products to consumers.
- For example, Eureka Forbes Ltd. sales water purifiers, vacuum cleaners etc. through direct selling. It includes selection, training, motivation and controlling sales force to handle selling as well as non-selling tasks effectively.

### (3) Sales Promotion:

- To achieve desired sales target in short period, company uses sales promotion, which includes gifts, coupon, prizes, extra quantity discounts etc.
- Recently this tool has become very popular and extensively used by all marketers. For example, Boomer chewing gum is popular among kids due to "tattoos" inside the packet.
- Thus, sales promotion is used for short duration and intends to achieve faster achievement of sales target.

### (4) Public Relations:

- To create sound and credible image of the whole company, public relation is developed. It is generally used in case of breakthrough innovation or at the time of new product launch.
- For example, when Tata launched its "Nano" car, at that time it got coverage in many newspapers and magazines

### 4. Place Mix (Distribution):

- The place mix is concerned with deciding about channels of distribution.
- It is concerned with number of intermediaries involved in distributing products. There are three kinds of distributions

(1) Exclusive distribution

(2) Selective distribution

(3) Intensive distribution for precious, costly and branded products, exclusive distribution strategy is used.



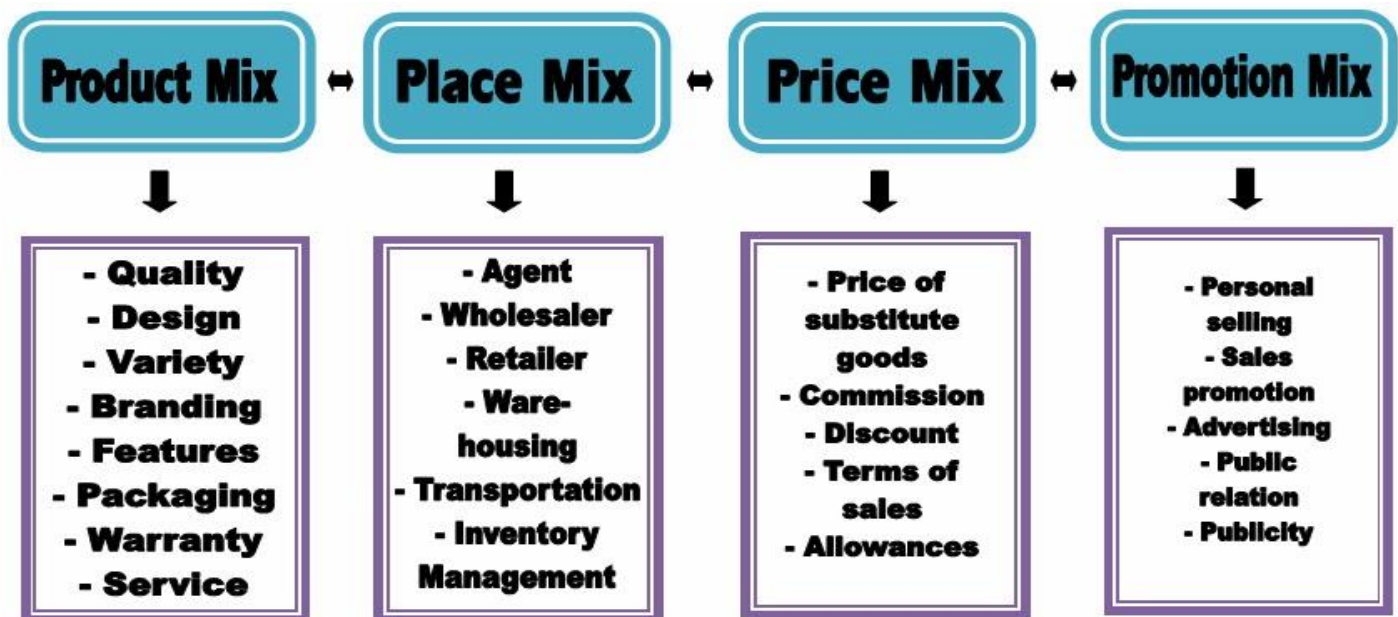
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- While for consumer durables, scooters, electronic items few outlets are selected to distribute the products. It is called selective distribution.
- While large number of outlets are made for FMCG and they are intensively distributed due to its large and frequent consumption.
- Further, this decision also includes physical distribution of goods from manufacturers to intermediaries to consumers.
- It includes transportation, warehousing etc.



### FACTORS AFFECTING MARKETING MIX

- Marketing mix is a set of marketing tools which can be used scientifically and rationally to influence and convince desired target markets.
- These tools depend on various factors. There are different marketing recipes to be served according to the taste and preference of target.
- Generally, following dimensions are considered while deciding Marketing Mix.

#### (1) Target Market:



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- Nature and type of target segment is a center point in deciding combination of marketing elements. For example, detergent powder, NIRMA focuses on economic class while Surf Excel and AREAL focuses on higher income group.
- Raymond is made for quality seekers as well as people searching for smooth fabric. While Reid and Taylor are for style promotion viewership and readers seekers.

### (2) Marketing Budget:

- Cost factor is having strongest impact on marketing decisions. For example, marketing tools of SSI and large-scale industries are different.
- Further, cost of product research, advertising expenditure, channel cost and pricing strategy etc. have to be designed only after considering marketing budget.

### (3) Nature of Product:

- Type of product, services and concept are major factors while designing marketing mix. For example, Industrial products, consumer products are marketed differently.
- Distribution channel, credit terms and pricing, advertising and promotion strategies are totally different from consumer products in case of industrial products.
- Further, for FMCGs, durable products services and concept marketing have special distribution channel, pricing and advertising strategies.

### (4) Size and Effectiveness of Competition:

- Among all the market conditions, competition is a driving factor of marketing actions. Higher the competition as well as impact of competition, there is a greater scope of product innovation, price competition and higher expenditure on promotion.
- For example, HUL heavily emphasizes on rejuvenation of all marketing tools because of the competition by P & G, Reckitt and Bank shire and other marketers in the category of personal care products.
- Due to entry of many "noodles" marketers, Nestle has launched many variants of "Maggi" Noodles.
- 

### (5) Marketing Objectives:

- The entire marketing process plans and programs are led to achieve a specific goal and mission. Thus, marketing mix is also designed to reach that destination.



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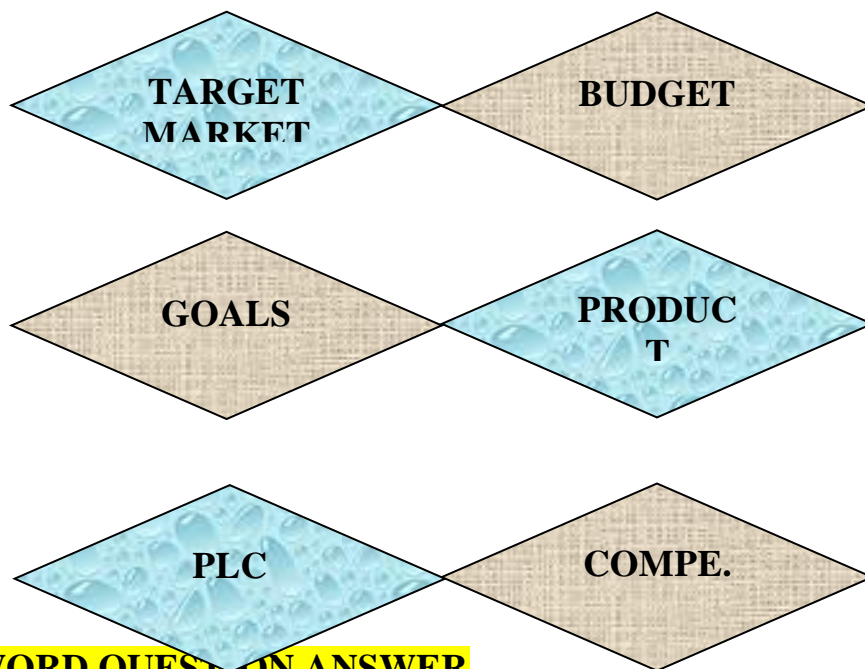
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- Vodafone has extensively focused on advertising and promotion in India initially because it wants to create and build a brand to replace Hutch effectively.
- Tata "NANO" has used publicity and created hype in the market to position itself the most affordable car i.e. (Khusio Ki Chabi). In short, the tools of marketing are set and structured in a way that objectives of marketing and organization are fulfilled.

## (6) Product Life Cycle:

- It is rightly said that the task of marketing is to influence timing and level of demand. To illustrate Skimming product life cycle penetration pricing strategies as well can be used in the introduction stage of product.
- Product and market modification are required in the growth stage of product life cycle. Hence when and which tool is to be stressed more is decided by product life cycle



### 1 WORD QUESTION ANSWER

<u>SR.NO</u>	<u>QUESTION</u>	<u>ANSWER</u>
1	Marketing mix is also known as??	4P'S
2	Give name of 4P.	Product, price, place, promotion



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3	It refers to the set of actions, or tactics, that a company uses to promote its brand or product in the market.	Marketing mix
4	Which are elements of marketing mix.	Product, price, place, promotion
5	It is a tangible good or an intangible service that is mass produced or manufactured on a large scale with a specific volume of units.	product
6	_____ is economic value of a product denominated in terms of money.	Price
7	Which are elements of promotion mix.	Advertising, personal selling, sales promotion, public relation
8	The _____ is concerned with deciding about channels of distribution.	place mix
9	Which factors affecting marketing mix.	Target Market, marketing budget, type of product, PLC





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### UNIT – 2 STP- SEGMENTATION, TARGETING AND POSITIONING

#### SEGMENTATION:

##### Introduction:

- A market segment is a group of people who share one or more common characteristics, lumped together for marketing purposes.
- Each market segment is unique, and marketers use various criteria to create a target market for their product or service. Marketing professionals approach each segment differently, after fully understanding the needs, lifestyles, demographics and personality of the target consumer.

##### Definition:

- “Market segmentation is the process of evaluating and categorizing customer groups to enable targeted marketing efforts. Businesses of every size undergo market segmentation to better understand and satisfy the needs of different consumers, also called target customers, to improve marketing efforts and offer the best products.”

##### Objectives / Need for Market Segmentation

- a) Market segmentation helps to look at the market consisting of customers who differ in their needs.
- b) To appeal all the buyers with different needs in the market.
- c) To fulfill the idea of serving a part instead of whole, this is more appropriate.
- d) Developing products and marketing programs, tailor made that is easy and effective.
- e) Companies can get competencies, by offering the differentiated product not only





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on basis of prices but also styling, packaging, promotional appeal, distribution methods and better services.

f) Market segmentation is considered as the best strategy for serving the target market.

### **PROCESS OF SEGMENTATION:**

#### *1) Determine the need of the segment*

- What are the [needs](#) of the customers and how can you group customers based on their [needs](#)? You have to think of this in terms of consumption by customers or what would each of your customer like to have.
- For example – In a region, there are many normal restaurants but there is no Italian restaurant or there is no fast food chain. So, you came to know the NEED of consumers in that specific region.

#### *2) Identifying the segment*

- Once you know the need of the customers, you need to identify that “who” will be the customers to choose your [product](#) over other offerings. Quite simply, you have to decide which type of segmentation you are going to use in this case.
- Is it going to be [geographic](#), [demographic](#), [psychographic](#) or what? The 1st step gives you a mass of crowd, and in the 2nd step, you have to [differentiate](#) the [people](#) from within that crowd.



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- Taking the same above example of Italian restaurant – The [target](#) will be children, youngsters and middle aged people. Italian food is generally not preferred by old age people who prefer food which can be easily chewed.

### 3) Which segment is most attractive?

- Now, we approach the [targeting](#) phase in the steps of market segmentation. Out of the various segments you have identified via demography, geography or psychography, you have to choose which is the most [attractive segment](#) for you.
- This is a tough question to answer because one of them will be left out.
- If you are using psychographic segmentation, then you need to target the [psychology](#) of consumers which takes time.
- So you will not be able to expand faster. But if your product is basic, then you can use [demographic](#) segmentation as the base, and expand much faster in surrounding regions. So this step involves deciding on ALL the [different types of segmentation](#) that you can use.
- Attractiveness of the firm also depends on the [competition](#) available in the segment. If the competition is too much in a given segment, then it does not make sense to take that segment into consideration. In fact, that segment is not attractive at all.
- Taking the above example of an Italian restaurant, the restaurant owner realizes that he has more middle aged people and youngsters in his vicinity.



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- So it is better to market his store on weekends and malls where this target group is likely to go. The middle aged people can bring children and elders as per their convenience.
- So the 1st target is the middle aged group, and the 2nd target is youngsters. He is using a combination of demographic and [geographic](#) segmentation to target middle aged people in his region.

#### 4) Is the segment giving profit

- So, now you have different [types of segmentation](#) being analysed for their attractiveness. Which segment do you think will give you the maximum crowd has been decided in the 3rd step.
- But which of those segments is most [profitable](#) is a decision to be taken in the 4th step. This is also one more targeting step in the process of segmentation.

#### 5) Positioning for the segment

- Once you have identified the most profitable segments via the steps of market segmentation, then you need to position your product in the mind of the consumers.
- I would not dive deep into [positioning](#) here as you can read this [quick guide to positioning](#). The basic concept is that the firm needs to place a value on its [products](#).
- If the firm wants a customer to buy their product, what is the value being provided to the customer, and in his mindset, where does the customer place the [brand](#) after [purchasing](#) the product? What was the [value of the product](#) to the customer and how valuable does he think



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the brand is – that is the work of positioning. And to complete the process of segmentation, you need to position your product in the mind of your segments.

- Example – In the above case we saw that the Italian restaurant owner was finding youngsters unprofitable. So what does he do? How does he target that segment as well? Simple. He starts a fast food chain right next to the Italian restaurant. What happens is, although the area has other fast food restaurants, his restaurant is the only one which offers good Italian cuisine and a good fast food restaurant next door itself. So both, the middle aged target group and the youngsters can enjoy. He has converted the profit earned from the middle aged group, into more profit, and has achieved top of the mind positioning for all people in his region.

### 6) *Expanding the segment*

- All segments need to be scalable. So, if you have found a segment, that segment should be such that the business is able to expand with the type of segmentation chosen. If the segment is very niche, then the business will run out of its course in due time. Hence the expansion of the segment is the second last step of market segmentation.
- In the above example, the Italian restaurant owner has the best process in his hand – an Italian restaurant combined with a fast food chain. He was using both Demographic and geographic segmentation. Now he starts looking at other geographic segments in other regions where he can establish the same concept and expand his business. Naturally, with more expansion he will earn more profits.



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### 7) *Incorporating the segmentation into your marketing strategy*

- Once you have found a segment which is profitable and expandable, you need to incorporate that segment in your marketing [strategy](#).
- How do you think [McDonalds](#) or [KFC](#) became such big chains of fast food? They had a very clear process of segmentation because of which it became easier to find regions to target.

### **SIGNIFICANCE /BENEFITS /IMPORTANCE OF MARKET SEGMENTATION**

#### **To find new product opportunities:**

- By segmenting the market, two issues can be targeted, group of customers, market not served all together and the market not served properly.
- Thus, companies can explore new opportunities or new products for consumers which will increase company's sales also.

#### **To identify new buyers for the product :**

- The organization can always identify new buyers for its product by segmenting the market effectively.
- Sales promotional or advertising campaigns can easily persuade the customers to buy new products. Thus, it helps to identify new buyers.

#### **To have effective marketing strategy :**

- Marketers can have very clear understanding of customers' need. As a marketer knows sufficiently about market, he can formulate and implement marketing plans and strategy accordingly.



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3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

### **To improve profitability :**

- Segmentation helps to produce goods according to the need of specific group of buyers. Thus, company can increase sales. An increased sale results into increased profits.

### **To avail maximum customer satisfaction :**

- Segmentation facilitates to gratify needs of customers more effectively.
- It's a two sided sword as it ensures maximum consumer satisfaction and maximum sales to the company.
- As customer gets the products exactly according to their requirements, customer satisfaction is sure to come.

### **To avail win-win-win approach :**

- Market segmentation is consumer oriented philosophy, thus, it focuses on the win-win-win approach.
- That is benefiting company itself, society and nation.
- With segmentation the right product of right quality and quantity can be catered to right groups of customers.
- This results into overall improvement in the economic system.

### **To benefit small scale units :**

- The small scale units are characterized with the limited manufacturing and marketing capacity. Thus, it becomes easy for the units to take advantage of market segmentation.
- Again, it can affordably manufacture the limited demand of a specific group with limited number of consumers. This also helps them to compete with the large industries.



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### **LIMITATIONS OF MARKET SEGMENTATION:**

#### **Expensive production and marketing :**

- To cater the different segments of buyers, producers have to produce products of various models, colours, sizes etc. that results into expensive production.
- Again, for the marketing of different segments various marketing strategies are to be formulated. This becomes an expensive affair.

#### **Difficulty in distribution :**

- Separate and special arrangement for each of the products demanded by different classes of customers is to be made.
- Company has to maintain separate channels for satisfying the various needs of the different group of customers.

#### **Heavy investment :**

- Market segmentation leads to heavy investment in variety of product lines and items.
- Thus company needs to invest more technology and other inputs that may ask for heavy investment.

#### **Problems of promotion :**

- In order to influence various segments of buyers, the company is required to prepare a separate advertising program or strategy.
- Thus personal selling and sales promotional activities become more complex.





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- As each group differs in term of advertising media, appeal or message, at times company faces the problem related to promotion.

### **Stock and storage problems :**

- To meet needs and want of different consumer groups, the company must maintain adequate stock of various products on a continuous basis.
- The working capital becomes the main constraint. There also rests the problems of stocks and storage.

### **Features / principles/Conditions of Effective Market Segmentation:**

#### **Measurable:**

- Consumers who belong to a particular target market and segment should be clearly identifiable.
- The characteristics to include or exclude in identification of a market segment are also well defined and measurable.
- Target markets are quantifiable in terms of population, income and age bracket, among other factors.

#### **Accessible:**

- Market segments should be accessible in terms of geography and economy.
- To enable accessibility of goods and services, there should be use of appropriate marketing strategies.



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- This is because the marketing strategy used for one group should differ from the strategy used for another, as their needs differ.
- For example, different age groups have different fashions, styles and consume different products. The way of communicating to this market segment should correspond to the relevant needs of consumers in this segment.

### **Profitable:**

- A market segment should be large enough to be worth pursuing.
- The main aim of market segmentation is to be able to tailor marketing techniques toward specific segments.
- This enables a firm to enjoy economies of scale while at the same time fulfilling consumers' needs.
- The amount of disposable income the target market is willing to spend in purchasing the goods and services should be enough to enable the firm to earn profits.
- For example, if a product's target market is young consumers, the price range should be attainable, considering that majority of the young people are dependent on their parents or guardians.

### **Sustainable:**

- The degree to which the segments are large and profitable to be served. A proper market segment is usually a homogeneous group with clearly defined features like age group, brand attitude, perception etc...

### **Differentiable:**



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- A good market segmentation is internally homogeneous means all customers within the segment have similar preferences and features but externally heterogeneous.

### **Bases for/Types of Market Segmentation**

#### **a) Bases for segmenting Consumer Market:**

- i. Consumer characteristics approach
- ii. Product characteristics approach

#### **a) Bases of Segmenting Consumer Market :**

##### **i) Consumer/People-oriented approach:**

- In people oriented basis of segmenting consumer markets, one is interested in finding out the probable type of customers who will buy the products.
- It is also called customer personal characteristics. The knowledge of personal characteristics, like who are the buyers, how do they live and think matters.

These variables are asunder.

#### **1. Geographic :**

- Geographic location is the usual and very popular basis for segmentation.
- In a country like India it can be on rural and urban basis, again it may be on city and suburban basis.

#### **2. Demographic :**

- It the study of type of population from different viewpoints like sex, age, marital status,



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number of children.

- It can be further understood as different consumers belong to different sex and age as male-female, old aged, adults, youngsters, teenagers, kids, and their demand vary accordingly.

### 3. **Psychographic :**

- It includes the variables like personality, lifestyles. Personality is the individual characteristics as dominance, aggressiveness, objectivity, achievements, motivation etc. which influences buying behaviour.

### 4. **Socio-economic:**

- They are income, education, occupation, family cycle, social class, religion and culture.
- Infrequently bought consumer items, we use socio-economic variables in segmenting the markets. All the variables mentioned above helps to know the tastes, preference, and ability to buy different products.

### ii) **Product oriented approach :**

- At times it is also required to know the reasons as to why the consumers buy a products or brand.
- It is also important to know their responses or behavior towards a product or a store. It is also called customer response approach.
- Hence this segmentation helps to find out buying behavior. These factors are:

#### 1) **Use pattern :**

- The frequency with which the consumer use the product can be taken into account. A buyer may be classified as heavy, medium, light users or non-users.



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### 2) Benefits :

- This gives emphasis on wants and desires of consumers.
- Benefits sought by consumers are the basic reason for the very existence of market segment.
- It is clear that consumer buy products to avail benefits.
- Again, customer satisfaction directly depends upon product benefits like economy, performance, style, durability, status, etc.

### 3) Brand/Store loyalty :

- Loyalty segmentation enables marketer to tailor the promotional contents and product appeal to retain the loyal customers, to attract new customers from rival brands or to convert non-loyal into loyal buyers.

### 4) Use of buyers attitude, perception etc :

- Different buyers with varied attitudes behave differently.
- Many variables like motivation, individual perception, and their preferences are studied and consumers are then segmented so that each efforts of marketing can be done to avail the consumers and retain them.

### (b) Bases for segmenting industrial market :

- Industrial market is different from that of the consumer market.
- The buyers in both the cases are different. Say for consumers' market they are the end users.



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- While, in the case of industrial products they are used as the inputs by manufacturing units for further processes on the products, or manufacturing other products.
- Again strict classification of industrial and consumer products is also difficult. For e.g. electricity, petrol, sugar etc. are used by industries as well as consumers for their daily use.
- Thus, the segmentation depends as to where the companies or manufacturing units sell their products.
- In fact, all the bases used for consumer markets can be applied to the industrial markets also.
- The only difference lies in definition of individual buyer.
- In case of industrial market, business unit, agency or company is considered as an individual buyer.
- While in the consumer markets, the actual buyers are the end users. Though, some new variables may be used for industrial segmentation.

### **Concept of Target marketing and Market targeting:**

#### **(i) Target market:**

- Target market is also called target customers.
- Target market is a group of people considered likely to buy a product or service.
- Target market consists of the customers that share similar characteristics, such as age, location, income and lifestyles to which a business directs its marketing efforts and sell its products.



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- For example ,the target market or target customers of Apple company is the people whose income is high.
- It is very important for a business to identify and select a target market so it can direct its marketing efforts to that group of customers and better satisfy their needs and wants.
- Also targeting makes it possible to collect more precise data about customers' needs and behaviors.
- Target markets or also known as target consumers are certain cluster of consumers with similar or the same needs that most businesses target to sell their products or services.
- It enables them to tap marketing opportunities better. Marketers develop a separate product for each target market.
- Thereby adjusting the pricing, distribution and advertising policies to reach the target markets most effectively.

### (ii) Market targeting :

- Market targeting is the process whereby one or more of market segments previously identified are evaluated and selected.
- The market targeting is defined as "the process of evaluating each market segment's attractiveness and selecting one or more segments to enter."
- It can also be understood like this that, the segment a company wants to serve is target market and the process of selecting the target market is referred as market targeting.

### **The Market Targeting Process :**

- We will now look at the process of Market Targeting in two simple steps. Firstly, we have to evaluate the market segments.





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- Then, we select target market segments. This last step goes hand in hand with choosing the targeting strategy.

### 1. **Evaluating Market Segments:**

- The market targeting process starts by assessing the different segments the company identifies in the market segmentation.
- But based on which criteria do it evaluates the segments is the concern. In assessing market segments, a company considers three factors. These are:
  - a) The segment size and growth
  - b) The segment structural attractiveness
  - c) The company objectives and resources
- a) **The segment size and growth :**
  - In order to evaluate segments, the company needs to collect and analyse relevant data first. This data may include information on current segment sales, growth rates and anticipated profitability of segments.
- b) **The segment structural attractiveness :**
  - In addition to the segment size and growth, its structural attractiveness play a significant role in market targeting.
  - The major structural factors that are meant here affect the segment's long-term attractiveness.
- c) **The company objectives and resources:**
  - Certainly, a favourable size, growth and structural attractiveness of a segment are not all in market targeting.



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- It has to match the company's own objectives and resources. If it does not fit the company's long-term objectives, there is no reason to enter it.

### 2. Selecting Target Market Segments:

- It refers to one set of buyers who share common needs or characteristics the firm decides to serve.
- So, the company has to decide which and how many segments it will target.
- A firm can target very broadly, which is called **undifferentiated marketing**.
- Market targeting can also be very narrow, which is called **micromarketing**.
- If it is somewhere in between, it might be **differentiated** or **concentrated market targeting**.

### 3. Market Targeting Strategies:

#### (i) **Undifferentiated (Mass) Marketing - Broad Market Targeting :**

- Undifferentiated Marketing is marketing that does not target a particular segment of the market.
- Undifferentiated Marketing usually involves targeting the whole market with one product.

#### (ii) **Differentiated Marketing Strategy :**

- Under a Differentiated Marketing Strategy, a company will develop products and services with separate marketing mix strategies for each of the segments chosen by the firm.

#### (iii) **Concentrated (Niche) marketing :**



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- Concentrated Marketing occurs when a business concentrates its marketing effort on one segment of the market.
- The firm will develop a product that caters for the needs of that particular group.
- Concentrated Marketing can have lower costs than the other two options.
- It can be a good option for small or new businesses.
- It also means that the firm needs to be sure that they have selected the correct segment of the market.

#### (iv) **Micromarketing - Narrow Market Targeting :**

- Micromarketing means nothing else than tailoring the marketing programmes and products to the needs and wants of individual consumers or local customers segments.
- The company can tailor their products and programmes to suit the tastes of specific locations of specific individuals.
- These may be relationship with the few customers the company focuses on utmost importance.

#### **Factors influencing the Choice of the Market :**

##### **The company's resources:**

- If resources are limited, a concentrated market targeting strategy might make more sense.

##### **The degree of product variability:**

- In case of uniform products, such as apples or steel, undifferentiated marketing may be more suited.
- In case of products that can vary in design (cars, cameras etc.), more narrow differentiation and concentration is suitable.



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### **The product life cycle:**

- When a company introduces a new product, it may be helpful to launch only one version.
- Undifferentiated or concentrated marketing might make most sense. In the mature stage, a segmented market targeting may be appropriate.

### **Market variability:**

- If you talk about a kind of product where all buyers have the same tastes, buy the same amounts etc. undifferentiated marketing makes sense.

### **Competitors' marketing strategies:**

- If competitors apply differentiated or concentrated market targeting strategies, using undifferentiated marketing may prove to be fatal.
- However, the firm might also gain an advantage by using a different market targeting strategy than competitors, especially if it can serve individual customers better by meeting their needs. Then, a concentrated market targeting strategy or micromarketing will work best.

### **Product Positioning**

#### **Concept of Product Positioning:**

- Positioning refers to the place that a brand occupies in the mind of the customer and how it is distinguished from competitors.
- Product positioning is a marketing technique intended to present products in the best possible light to different target audience. It is a form of marketing that presents the benefits of product to a particular target audience.



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### Objectives of Product Positioning :

1. It should be meaningful and should attract the targeted audience.
2. Should develop capability to differentiate the strengths of the product against the competitors.
3. It should be significant enough for large targeted audience.
4. It should satisfy the need of the customers.
5. It should be believable and reliable for the targeted audience.

### 4. Role/Importance/Utility of Product Positioning:

#### a) Support overall strategy:

- Creating a clear positioning for a brand/product in the market place is often an integral part of an organization's overall marketing strategy.

#### b) Differentiate offerings :

- Clear positioning helps the consumer differentiate between competitive offerings (as well as between similar offerings from the same brand).
- As we know, part of the key to marketing success is the ability to differentiate on some important features / benefits to the target.

#### c) Competitive position :

- Having a number of clearly positioned products/brands increases the competitive strength of the organization in the market place.
- Their brand equity is stronger and they 'own' more market space.



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### d) Increase sales and customer loyalty :

- Brands/products that are well understood by consumers will typically generate higher sales levels, as they are seen as the ideal product solution for particular consumer needs.
- As a result, these customers become less likely to switch to competitive offerings.

### g) Good for habitual purchases :

- Many supermarket style products (that is, FMCGs- fast moving consumer goods) are bought on a habitual basis.
- If a product is well positioned on key attributes/benefits, then the consumer can internally rationalize why they buy the same product on a regular basis without consideration of the competitive offerings.

### h) Facilitate W-O-M :

- For products that are more prone to word-of-mouth (W-O-M) communication, being positioned around a few key benefits / features makes it much easier for the target market to communicate the advantages of the product to other consumers.

## Product Positioning Strategies/7 Approaches to Positioning Strategy of

### aProduct:

Positioning strategies can be conceived and developed in a variety of ways. It can be derived from the object attributes, competition application, the types of consumers involved, or the characteristics of the product class.

### (1) Using product characteristics or customer benefits:



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- A new product is positioned with respect to a product characteristic that competitors have ignored.
- Sometimes a product attempts to position itself along two or more product characteristics simultaneously.

### a. **Physical characteristics:**

- These are the most objective criteria and can be measured on some physical scale such as temperature, color intensity, distance, strength of fragrance etc.

### b. **Pseudo-physical characteristics:**

- These reflect physical properties that are not easily measured. The examples are spiciness, type of fragrance, shiniess, creaminess etc.

### c. **Benefits:**

- These refer to advantages that promote the well being of the consumer. Examples are thirst quenching, hunger satisfying, not harming the skin etc.

### (2) **The price-quality approach:**

- This approach justifies various price-quality categories of the products.
- Manufactures intentionally attempt to offer more in terms of service, features or performance in case of certain products known as Premium products and in return, they charge higher price, partly to cover higher costs and partly to help communicate the fact they are of higher quality.

### (3) **The use or applications approach:**

- Another way to position is to consider the use or application.
- Such type of positioning is done deliberately to expand the brand's market.





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- Many companies are introducing new uses of the product that will automatically expand the brand's market.

#### (4) **The product-user approach:**

- This deals with positioning a product keeping in mind a specific user or a class of users.
- Cosmetics brands like Revlon, Lakme position themselves targeting fashion conscious women.
- Makes of casual clothing like jeans have introduced 'designer labels' to develop a fashion image.

#### (5) **The product-class approach:**

- Some products need to make critical positioning decisions that involve product-class associations.
- This can be done if two products lie in the same product class. Thus, by joint promotions, both of these products improve their positioning.
- Positioning by products class mainly uses sales promotion as its tool. Thus, depending on the product class, company can position or reposition its product or brand.

#### (6) **The cultural symbol approach:**

- Many companies use deeply deep-rooted cultural symbols to differentiate their brands from their competitors.
- In today's world many advertisers are using deeply deep-rooted cultural symbols to differentiate their brands from that of competitors. Using and popularizing trademarks generally follow this type of positioning.

#### (7) **The competitor approach:**



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- The positioning can be made with an clear or implied frame of reference of one or more competitors.
- In some cases, reference competitor(s) can be the dominant aspect of the positioning strategies of the firm, the firm either uses the same or similar positioning strategies as used by the competitors or the advertiser uses a new strategy taking the competitors' strategy as the base.
  - a. The competitor may have a firm, well-defined image developed over many years and this image can be used as a bridge to help to communicate another image referenced to it. It is like when you give your address, you mention some well known landmarks like bank, office, school etc.
  - b. It is important that they believe you are better than a given competitor.

### **Product positioning process /Steps to product positioning):**

Marketers with the positioning process try to create a unique identity of a product amongst the customers. Philip Kotler, has given simple stages of product positioning. Here it has been simplified into following stages:



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### Flow chart of process of positioning of the product

a. Know your target audience well

-

b. Identify the product features

-

c. Unique selling propositions

-

d. Know your competitors

-

e. Promote the benefits of product

f. Maintaining brand position

4.

(a) **Know your target audience well** :It is essential for the marketers to first identify the target audience and then understand their needs and preferences.

(b) **Identify the product features** :The marketers themselves must be well aware of the features and benefits of the products.

(c) **Unique selling propositions** :Every product should have USPs; at least some features which are unique. The organizations must create USPs of their brands and effectively communicate the same to the target audience. The marketers must themselves know what best their product can do.



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(d) **Know your competitors** :This stage is very crucial. A marketer must be aware of the competitor's offerings. The marketers must always strive hard to have an edge over their competitors.

(e) **Ways to promote brands** :One must choose the right them for the advertisement.Catchy taglines must beused.

(f) **Maintain the position of the brand** :Foran effective positioning it is essential for the marketers to continue to live up to the expectations of the end-users. The company should never compromise on quality. And also should not drastically reduce the price of yourproducts.

### DETERMINANTS/ FACTORS OF SUCCESSFUL PRODUCT POSITIONING:

The marketing firm that wants to achieve a thundering success with its product positioning strategy should fulfil the following conditions.

#### 1. Design creative product proposition:

- Product proposition means the offer of benefits accruing from the use of the product. In other words, it concerns it-self with outstanding product features.
- The proposition to be perceived by the consumers is one that is desired by the firm proposing.
- The results of positioning are increased satisfaction to the users and profits to the sellers through increased sales.
- The product proposal is bound to be impressing and appealing than those of competitors if a novelty is shown via creativity.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

### 2. Existence of warranted competition:

- The positioning strategy is likely to be victorious in case there is competition warranting product positioning.
- Positioning is a strategy. Strategy is a counter-plan to meet the challenges of opponents in the field or any odd situation that has cropped up.
- Product positioning or repositioning is always done in response to the product positioning or repositioning done by competitors. So long as competitors are not coming in your way, you need not worry.
- In case they challenge your stand or position, then repositioning is a must as the only way out to survive and succeed.

### 3. Sizeable and profitable market segment:

- Market segments must be large enough to make it profitable for a manufacturer or marketer to concentrate his resources on such as market.
- For example, it is possible to identify people who are likely to spend most of their waking hours in shopping and thinking about the ways they can save money.
- Though it is possible that such people exist in our community, it would be doubtful that their number is worth trying to reach them.
- Even if such neurotically price conscious people are existing in large number, there is one more problem with them.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

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- That is, how to identify them? Rather accurately? These are odd- men not fitting with other characteristics.
- In effect, therefore, a market segment must contain enough people to make a profitable market and must be identifiable in order to implement such a strategy.

#### 4. Sensitive market segment:

- A sensitive market segment is one that receives the communication message transmitted by the company and reacts to it.
- That is, a segment should make differential response to the marketing efforts put in by the company.
- That is, the efficient marketer is aiming at equal marginal response from the unit of the marketing effort applied in each market.
- The communications designed especially for a segment must be understood; the company wants to consumers to understand or perceive.

#### 5. Adequate consumer behaviour information:

- Product positioning presupposes the availability of adequate, detailed and up-to-date information regarding the consumers, especially their behavior.
- Basically, product positioning is one of the alternatives for matching the consumer self-image with the company product image.
- It is a matter of collecting, analysing and interpreting the consumer behaviour. The specific aspects of consumer behaviour can be-what they buy? Why they buy? Who does buying?



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

How they buy? How much they buy? Where they buy? When they buy? In brief, it is the study of his decision to buy and how the company can convince him of the company product in meeting the consumer needs.

### **ERRORS IN PRODUCT POSITIONING:**

- positioning the company or the product pertains concrete action.
- The success is the outcome of the smart deeds and words by manifestation done by the marketing efforts by the company, a wise company always tries to avoid positioning errors.

Kotler says that the firm should avoid four major positioning error, namely:

**Under positioning:** this occurs when the buyers know much less about the brand or do not know anything special about the brand.

**Over positioning:** when the buyers have too narrow a view of the firm, the product or brand, for example, buyers may perceive Ram Maica as offering only quality decorative laminates, when in reality it offered decorative glass and flush door too.

**Confused positioning:** buyers may have a confused image of the brand, this may occur as a result of the frequent changes in the positioning statement.

**Doubtful positioning:** it occurs when buyers doubt the veracity of the claims made by the firm.

### **Difference between brand positioning and product positioning:**





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 Ph. No–(0281)2471645

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 Nr. Amrapali Railway Crossing  
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## Product Positioning v/s Brand Positioning

Product positioning is the process used to determine how to best communicate product attributes to the target customers based on customer needs.

Brand positioning refers to the rank in customers' mind the company's brand possess in relation to the competition.

### Nature

Product positioning is based on competitive differentiation.

Brand positioning is based on emotional experience.

### Focus

The focus of product positioning is to fill all the need gaps of the customer base.

Brand positioning is focused on catering to specific customer needs.

### Measure

The success of product positioning can be measured by market share.

The success of brand positioning is largely intangible in nature.



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**Raiya Road, Rajkot – 360001**  
**Ph. No–(0281)2471645**

**2- Vaishalinagar**  
**Nr. Amrapali Railway**  
**Raiya Road, Rajkot – 360001**  
**Ph.No–(0281)2440478, 2472590**

## INTRODUCTION OF STP:

- STP Marketing stands for segmentation, targeting and positioning. STP Marketing makes the process of marketing easy. It is very easy to understand and apply in business.
- The main goal of STP Marketing is to attract the customer and not only to attract the customer but also getting the right customer who will be interested in our product.

## PROCESS OF STP:

### Step 1: Segmentation

- Any organization, product or brand can't be all things to all people.
- This is why you need to use [market segmentation](#) to divide your customers into groups of people with common characteristics and needs.
- This allows you to tailor your approach to meet each group's needs cost-effectively, and this gives you a huge advantage over competitors who use a "one size fits all" approach.

There are many different ways to segment your target markets. For example, you can use the following approaches:

- **Demographic** – By personal attributes such as age, marital status, gender, ethnicity, sexuality, education, or occupation.
- **Geographic** – By country, region, state, city, or neighborhood.
- **Psychographic** – By personality, risk aversion, values, or lifestyle.



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(AFFILIATED TO SAURASHTRA UNIVERSITY & GTU)

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**Raiya Road, Rajkot – 360001**  
**Ph. No–(0281)2471645**

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- **Behavioral** – By how people use the product, how loyal they are, or the benefits that they are looking for.

## Step 2: Targeting

- Next, marketer decides which segments to target by finding the most attractive ones. There are several factors to consider here.
- First, look at the profitability of each segment. Which customer groups contribute most to your bottom line?

## Step 3: Positioning

- In this last step, your goal is to identify how marketer want to position his product to target the most valuable customer segments. Then, you can select the [marketing mix](#) that will be most effective for each of them.
- First, consider why customers should purchase your product rather than those of your competitors. Do this by identifying your [unique selling proposition](#) , and draw a [positioning map](#) to understand how each segment perceives your product, brand or service. This will help you determine how best to position your offering.



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(AFFILIATED TO SAURASHTRA UNIVERSITY & GTU)

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**Ph. No–(0281)2471645**

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**Ph.No–(0281)2440478, 2472590**

## UNIT – 3 Consumer Behavior & buying process

### INTRODUCTION:

- Consumer behavior is the study of how individual customers, groups or organizations select, buy, use, and dispose ideas, goods, and services to satisfy their needs and wants.
- It refers to the actions of the consumers in the marketplace and the underlying motives for those actions.
- Marketers expect that by understanding what causes the consumers to buy particular goods and services, they will be able to determine—which products are needed in the marketplace, which are obsolete, and how best to present the goods to the consumers.

### DEFINITION:

- According to Engel, Blackwell, and Mansard, ‘consumer behaviour is the actions and decision processes of people who purchase goods and services for personal consumption’.

### CHARACTERISTICS / NATURE OF CONSUMER BEHAVIOUR:

#### **Systematic process:**

- Consumer behavior is a systematic process relating to buying decisions of the customers. The buying process consists of the following steps :
- Need identification to buy the product
- Information search relating to the product
- Listening and evaluating the alternative



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- Purchase decision
- Post purchase evaluation by the marketer

### **Influenced by various factors:**

- Consumer behavior is influenced by a number of factors the factors that influence consumers include marketing, personal, psychological, situational, social and cultural etc.

### **Different for different customers:**

- All consumers do not behave in the same manner. Different consumers behave differently. The different in consumer behavior is due to individual factors such as nature of the consumer's lifestyle, cultures.

### **Different for different products :**

- Consumer behavior is different for different products there are some consumers who may buy more quantity of certain items and very low quantity of some other items.

### **Vary across regions :**

- The consumer behaviors vary across States, regions and countries. For instance, the behavior of urban consumers is different from that of rural consumers. Normally rural consumers are conservative (traditional) in their buying behavior.

### **Vital for marketers:**

- Marketers need to have a good knowledge of consumer behavior they need to study the various factors that influence consumer behavior of the target customers.



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- The knowledge of consumer behavior enables marketers to take appropriate marketing decisions.

### **Reflect status :**

- Consumer buying behaviour is not only influenced by status of a consumer come but it also reflects it. Those consumers who owned luxury cars, watches and other items are considered by others as persons of higher status.

### **Result in spread effect :**

- Consumer behaviour as a spread effect. The buying behaviour of one person may influence the buying behaviour of another person.
- For instance, a customer may always prefer to buy premium brands of clothing, watches and other items etc.
- This may influence some of his friends, neighbours and colleagues. This is one of the reasons why marketers use celebrities like Shahrukh Khan, sachin to endorse their brands.

### **Undergoes a change :**

- The consumer behaviour undergoes a change over a period of time depending upon changes in age , education and income level etc.
- for example, kids may prefer colourful dresses but as they grow up as teenagers and young adults, they may prefer trendy clothes.



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## **Information search :**

- Search for information is a common consumer behaviour. Consumers cannot purchase goods and services if they are unaware that a good or service exists.
- When a consumer decides to buy a certain item, his decision must be based on the information he has gathered about what products our services are available to fulfill his needs.

## **Brand loyalty:**

- Brand loyalty is another characteristic of consumer behavior.
- Brand loyalty is the tendency of a consumer to buy product products or services from a certain company that one likes or equates with having high quality goods and services.

## **SCOPE OF CONSUMER BEHAVIOUR:**

### **1) Consumer behaviour and marketing management :**

- Effective business managers realize the importance of marketing to the success of their firm.
- A sound understanding of consumer behavior is essential to the long run success of any marketing program.
- In fact, it is seen as a soul or main part of the Marketing concept, an important orientation of philosophy of many marketing managers.
- The essence of the Marketing concept is captured in three interrelated orientations consumers needs and wants, company integrated strategy.





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## 2) Consumer behaviour and non profit and social marketing:

- In today's world even the non-profit organisations like government agencies, religious sects, universities and charitable institutions have to market their services for ideas to the "target group of consumers or institution."
- At other times these groups are required to appeal to the general public for support of certain causes or ideas. Also they make their contribution towards eradication of the problems of the society.
- Thus a clear understanding of the consumer behaviour and decision making process will assist these efforts.

## 3) Consumer behaviour and government decision making :

- In recent years the relevance of consumer behaviour principles to government decision making. Two major areas of activities have been affected:
  - i) Government services: It is increasingly and that government provision of public services can benefit significantly from an understanding of the consumers, or users, of the services.
  - ii) Consumer protection: Many Agencies at all levels of government are involved with regulating business practices for the purpose of protecting consumer's welfare.

## 4) Consumer behavior and remarketing:

- It has become increasingly clear that consumers are entering an era of scarcity in terms of some natural gas and water.



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- These scarcities have led to promotions stressing conservation rather than consumption. In other circumstances, consumers have been encouraged to decrease or stop their use of particular goods believed to have harmful effects.
- Programs designed to reduce drug abuse, gambling, and similar types of conception examples.
- These actions have been undertaken by government agencies nonprofit organizations, and other private groups. The term "demarketing" refers to all such efforts to encourage consumers to reduce their consumption of a particular product or services.

### **5) Consumer behaviour and consumer education:**

- Consumer also stands to benefit directly from orderly investigations of their own behaviour.
- This can occur on an individual basis or as part of more formal educational programs. For example, when consumers learn that a large proportion of the billions spend annually on grocery products is used for impulse purchases and not spend according to pre planned shopping list, consumers may be more willing to plan effort to save money.
- In general, as marketers that can influence consumers' purchases, consumers have the opportunity to understand better how they affect their own behavior.



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## **ROLE, IMPORTANCE AND SIGNIFICANCE OF CONSUMER**

### **BEHAVIOUR:**

#### **Production policies:**

- The study of consumer behaviour effects production policies of enterprise.
- Consumer behaviour discovers the habits, tastes and preferences of consumers and such discovery enables an enterprise to plan and develop its products according to these specifications.
- It is necessary for an enterprise to be in continuous touch with the changes in consumer behaviour so that necessary changes in products may be made.

#### **Price policies:**

- The buyer behavior is equally important in having price policies.
- The buyers of some products purchase only because particular articles are cheaper than the competitive articles available in the market.

#### **Decision regarding channels of distribution:**

- The goods, which are sold and solely on the basis of low price mass and economical distribution channels.
- In case of those articles, which are like T.V. sets, refrigerators etc. Must have different channels of distribution. Thus, decisions regarding channels of distribution are taken on the basis of consumer behaviour.

#### **Decision regarding sales promotion:**

- Study of consumer behavior is also vital in making decisions regarding sales promotion.



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(AFFILIATED TO SAURASHTRA UNIVERSITY & GTU)

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- It enables the producer to know what motive prompt consumer to make purchase and the same are utilized in promotional campaigns to awaken desire to purchase.

### **Exploiting marketing opportunities:**

- Study of consumer behaviour helps the marketers to understand the consumers needs, aspirations, expectations, problems etc.
- This knowledge will be useful to the marketers in exploiting marketing opportunities and meeting the challenges of the market.

### **Consumer do not always act or react predictably:**

- The consumers of the past used to react to price levels as if price and quality had positive relation.
- Today, we value for money, lesser price but with superior features. The consumers response indicates that the shift had occurred.

### **Highly diversified consumer preferences:**

- This shift has occurred due to availability of more choice now. Thus study of consumer behavior is important to understand the changes.

### **Rapid introduction of new products:**

- Rapid introduction of new product with technological advancement has made the job of studying consumer behaviour more imperative.
- For example, the information Technologies are changing very fast in personal computer industry.

### **Implementing the "Marketing concept":**



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- These calls for studying the consumer behaviour, all customers need have to be given priority.
- Thus identification of target market before production becomes essential to deliver the desired customer satisfaction and delight.

## **APPLICATIONS / MANAGERIAL / IMPLICATION OF CONSUMER**

### **BEHAVIOUR:**

#### **1) Analyzing market opportunity:**

- Consumer behaviour study help in identifying the unfulfilled needs and wants of consumers.
- This requires examining the trends and conditions operating in the Marketplace, consumers lifestyle, income levels and energy influences.
- This may reveal unsatisfied needs and wants. Mosquito repellents have been marketed in response to a genuine and unfulfilled consumer need.

#### **2) Selecting target market:**

- Review of market opportunities often helps in identifying distinct consumer segments with very distinct and unique wants and needs.
- Identifying these groups, behaviors and how they make purchase decisions enable the marketer to design and market products or services particularly suited to their wants and needs.

#### **3) Marketing-mix decisions:**

- Once unsatisfied needs and wants are identified, the marketer has to determine the right mix of product, price, distribution and promotion.
- Where too, consumer behaviour study is very helpful in finding answers



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too many perplexing questions. The factors of marketing mix decisions are:

i) product ii) price iii) promotion iv) distribution

#### **4) Use in social and non profits marketing:**

- Consumer behaviour studies are useful to design marketing strategies by social, governmental and not for profit organisations to make their programmes more effective such as family planning, awareness about AIDS.

#### **TYPES OF CONSUMER BEHAVIOUR:**

- Wants are unlimited and the resources to satisfy these wants are limited.
- So the consumers think rationally before buying any product. Buying a toothpaste is totally different from buying a luxury car.
- The more expensive the good is the more information is required by the consumer.
- There are four types of consumer buying behavior on the basis of buyer involvement while purchasing any product.

**High involvement:** - the term means when the consumer is highly involved while buying a product. Generally this situation happens in case of expensive or luxuries goods. Like while buying a diamond necklace a consumer is highly involved.

**Low involvement:** - this term means when the consumer is not highly involved while buying a product. It happens in case of low price goods. Like while buying toothpaste a consumer is not highly involved.



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***Significant differences between brands:-*** it means when there are significant differences between brands.

***Few differences between brands:-*** it means when there are very little differences between brands.

## **MAIN TYPES OF BUYING BEHAVIOR:**

### **1) Complex buying behavior:-**

- when the consumer is highly involved in the buying and there is significant differences between brands then it is called complex buying behavior.
- So in this case the consumer must collect proper information about the product features and the marketer must provide detailed information regarding the product attributes.
- For e.g. Consumer while buying a *motor cycle* is highly involved in the purchase and has the knowledge about significant differences between brands.

### **2) Variety seeking behavior:-**

- In this case consumer involvement is low while buying the product but there are significant differences between brands. Consumers generally buy different products not due to dissatisfaction from the earlier product but due to seek variety.





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- Like every time they buy different *washing detergent* just for variety. So it is the duty of the marketer to encourage the consumer to buy the product by offering them discounts, free samples and by advertising the product a lot.

### 3) Dissonance buying behavior:-

- Here consumer is highly involved in the purchase but there are few differences between brands.
- Like consumer while buying a *floor tiles* buy them quickly as there are few differences between brands.

### 4) Habitual buying behavior:-

- In this case there is low involvement of the consumer and there are few differences between brands. The consumer buys the product quickly. For eg. *Toothpaste*.

## **FACTORS AFFECTING CONSUMER BEHAVIOUR**

There are several factors that influence consumer purchases, such as social, cultural, personal and psychological. The explanation of these factors is as follows.

### **Cultural Influences:**

Consumer behavior is deeply influenced by cultural factors, such as buyer's culture, subculture and social class.

- ❖ **Culture:** Essentially, culture is the share of each company and is the major cause of the person who wants and behavior. The influence of culture on the purchasing behavior varies from country to country,



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therefore sellers have to be very careful in the analysis of the culture of different groups, regions or even countries.

- ❖ **Subculture:** Each culture has different subcultures, such as religions, nationalities, geographical regions; racial, etc. marketing groups may use these groups, segmenting the market in several small portions. For example, marketers can design products according to the needs of a specific geographical group.
- ❖ **Social Class:** Every society has some kind of social class is important for marketing because the buying behavior of people in a particular social class is similar. Thus marketing activities could be adapted to different social classes. Here we should note that social class is not only determined by income, but there are several other factors such as wealth, education, occupation etc.

### **Social factors**

Social factors also influence the purchasing behavior of consumers. Social factors are: the reference groups, family, the role and status.

- ❖ **Reference groups:** Reference groups have the potential for the formation of an attitude or behavior of the individual. The impact of reference groups vary across products and brands. For example, if the product is visible as clothing, shoes, car etc., the influence of reference groups will be high. Reference groups also include opinion leader (a person who influences others by his special skill, knowledge or other characteristics).



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- ❖ **Family**: Buyer behavior is strongly influenced by a family member. So vendors are trying to find the roles and influence of the husband, wife and children. If the decision to purchase a particular product is influenced by the wife of then sellers will try to target women in their ad. Here we should note that the purchase of roles change with changing lifestyles of consumers.
- ❖ **Roles and Status**: Each person has different roles and status in society in terms of groups, clubs, family, etc. organization to which it belongs. For example, a woman working in an organization as manager of finance. Now she is playing two roles, one of the chief financial officer and the mother. Therefore, purchasing decisions will be influenced by their role and status.

### **Personal factors**

Personal factors may also affect consumer behavior. Some of the important factors that influence personal buying behavior are: lifestyle, economic status, occupation, age, personality and self-esteem.

- ❖ **Age**: Age and life cycle have a potential impact on the purchasing behavior of consumers. It is obvious that consumers change the purchase of goods and services overtime. Family life cycle consists of different stages as young singles, married couples, and unmarried couples etc. that help marketers to develop suitable products for each stage.
- ❖ **Occupation**: The occupation of a person has a significant impact on their buying behavior. For example, a marketing manager of an



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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

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Nr. Amrapali Railway  
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organization is trying to buy business suits, while a low level worker in the same organization buy-resistant clothing works.

- ❖ **Economic situation:** Economic situation of the consumer has a great influence on their buying behavior. If income and savings a customer is high, then going to buy more expensive products. Moreover, a person with low income and savings buy cheap products.
- ❖ **Lifestyle:** A Lifestyle client is another factor affecting import purchasing behavior of consumers. Lifestyle refers to the way a person lives in a society and express things in their environment. It is determined by the client's interests, opinions, etc. and activities shape their whole pattern of acting and interacting in the world.
- ❖ **Personality:** Personality changes from person to person, time to time and place to place. Therefore, it can greatly influence the buying behavior of customers. In fact, personality is not what one has, but is the totality of the conduct of a man in different circumstances. Has a different characteristic, such as dominance, aggression, confidence etc. that may be useful to determine the behavior of consumers to the product or service.

### **Psychological Factors**

There are four major psychological factors that affect the purchasing behavior of consumers.

These are: perception, motivation, learning, beliefs and attitudes.

- ❖ **Motivation/Motive:** The level of motivation also affects the purchasing behavior of customers. Each person has different needs, such as



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physiological needs, biological needs, social needs, etc. The nature of the requirements is that some are more urgent, while others are less pressing. Therefore, a need becomes a motive when it is most urgent to lead the individual to seek satisfaction.

- ❖ **Perception:** Select, organize and interpret information in a way to produce a meaningful experience of the world is called perception. There are three different perceptual processes which are selective attention, selective distortion and selective retention. In the case of selective attention, sellers try to attract the attention of the customer. Whereas in case of selective distortion, customers try to interpret the information in a way that supports what customers already believe. Similarly, in the case of selective retention, marketers try to retain information that supports their beliefs.
- ❖ **Beliefs and Attitudes:** Client has specific beliefs and attitudes towards different products. Because such beliefs and attitudes shape the brand image and affect consumer buying behavior so traders are interested in them. Marketers can change beliefs and attitudes of customers with special campaigns in this regard.

### **BUYING BEHAVIOUR MODELS:**

- ❖ To achieve success in the modern marketing, the marketing manager has to study consumer behavior because he can create, maintain and increase the demand for his companies' products only when he understands the feelings, desires, and buying motives of his consumers.



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- ❖ Thus, the buyer behavior models are broadly classified into the following categories:

### **Economic Man Model**

In this model, consumers follow the principle of maximum utility based on the law of diminishing marginal utility. Economic man model is based on the following effects –

- **Price Effect** – Lower the price of the product more will be the quantity purchase.
- **Substitution Effect** – Lower the price of the substitute product, lower will be the utility of the original product purchase.
- **Income Effect** – When more income is earned, or more money is available, quantity purchased will be more. The economic theory of buyer's decision-making was based on the following assumptions–
  - As consumer resources are limited, he would allocate the available money which will maximize the satisfaction of his needs & wants.
  - Consumers have complete knowledge about the utility of each product and service, i.e., they are capable of completing the accurate satisfaction that each item is likely to produce.
  - As more units of the same item are purchase the marginal utility or satisfaction provided by the next unit of the item will keep on decreasing, according to the law of diminishing marginal utility.



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- Price is used as a measure of sacrifice in obtaining the goods or services. The overall objective of the buyer is to maximize his satisfaction out of the act of purchase.

### Learning Model

- This model suggests that human behavior is based on some core concepts – the drives, stimuli, cues, responses and reinforcements which determine the human needs and wants and needs satisfying behavior.
  - Drive** – A strong internal stimulus which compels action.
  - Stimuli** – These are inputs which are capable of arousing drives or motives.
  - Cues** – It is a sign or signal which acts as a stimulus to a particular drive.
  - Response** – The way or mode in which an individual reacts to the stimuli.

### The Psychoanalytic Model–

- The model suggests that human needs operate at various levels of consciousness. His motivation which is in these different levels, are not clear to the casual observer.
- They can only be analyzed by vital and specialized searching.

### Sociological Model–

- This is concerned with the society.





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- A consumer is an element of the society and he may be a member of many groups and institutions in a society.
- His buying behavior is influenced by these groups. Primary groups of family friend's relatives and close associates extract a lot of influence on his buying.
- A consumer may be a member of a political party where his dress norms are different from different member.
- As a member of an elite organization, his dress needs may be different, thus he has to buy things that confirm to his lifestyle in different groups.

### **BUYING MOTIVES**

#### **MEANING AND DEFINITION:**

- The basis of modern marketing activities is the slogan, “Consumer is the king of market”. A customer purchases the goods and services due to several motives such as physical, social and economical forces that create a need or a desire for the product.
- The marketing manager can be successful in selling his products only when he identifies these forces.
- For example, in winter seasons we are motivate to purchase the woolen clothes to protect from the cold. Similarly, we are motivated to purchase the coolers in summer season to get the relief from the hot. These forces are known as buying motives.



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- Thus, a buying motive is the force for the satisfaction of which a customer purchases some goods and services. In simple words, buying motive is the reason why a consumer purchases a good.

### **IMPORTANCE OR SIGNIFICANCE OF STUDY OF BUYING**

#### **MOTIVES:**

The following points explain the importance of buying motives:

- Product planning and Development
- Pricing policies
- Distribution channel
- Promotional policies

#### **REASONS OF BUYING:**

- Desire to gain
- Satisfaction of emotions
- Fear of loss
- Comfort and convenience
- Pride and ownership

### **TYPES / CLASSIFICATION OF BUYING MOTIVES:**

- Buying motive is the urge or motive to satisfy a desire or need that makes people buy goods or services.
- Behind every purchase there is a buying motive. It refers to the thoughts, feelings, emotions and instincts, which arouse in the buyers a desire to buy an article.



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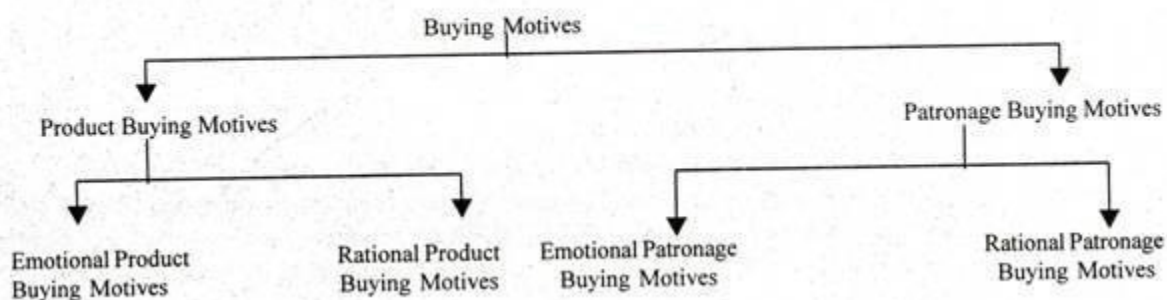
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- A buyer does not buy because s/he has been persuaded by the salesman, but s/he buys for the aroused desire in him or her. Motives should be distinguished from instincts.
- A motive is simply a reason for carrying out a particular behaviour and not an automatic response to a stimulus, whereas instincts are pre-programmed responses, which are inborn in the individual and involuntary.
- Thus hunger is an instinct whereas desire to purchase pizza is a buying motive.
- According to Prof. D. J. Duncan, “Buying Motives are those influences or considerations which provide the impulse to buy, induce action and determine choice in the purchase of goods and services.” Buying motives are can be divided by the following way:

FIGURE 2.5: THE CLASSIFICATION OF BUYING MOTIVES





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## **Product Buying Motives:**

- Product buying motives refer to those influences and reasons, which prompt (i.e. induce) a buyer to choose a particular product in preference to other products.
- They include the physical attraction of the product (i.e. the design, shape, dimension, size, colour, package, performance, price etc. of the product) or the psychological attraction of the product (i.e. the enhancement of the social prestige or status of the purchaser through its possession), desire to remove or reduce the danger or damage to life or body of the possessor, etc. In short, they refer to all those characteristics of a product, which induce a buyer to buy it in preference to other products.

Product buying motives may be sub-divided into two groups, viz., **(1) emotional product buying motives and (2) rational product buying motives.**

### **A. Emotional Product Buying Motives:**

- When a buyer decides to purchase a product without thinking over the matter logically and carefully (i.e., without much reasoning), she is said to have been influenced by emotional product buying motives. Emotional product buying motives include the following:
  1. **Pride or Prestige:** Pride is the most common and strongest emotional buying motive. Many buyers are proud of possessing some product (i.e., they feel that the possession of the product increases their social prestige or status). For instance, diamond merchants sell their products by suggesting to the buyers that the possession of diamonds increases their



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prestige or social status.

2. **Emulation or Imitation:** Emulation, i.e., the desire to imitate others, is one of the important emotional buying motives. For instance, a housewife may like to have a silk saree for the simple reason that all the neighboring housewives have silk sarees.
3. **Affection:** Affection or love for others is one of the stronger emotional buying motives influencing the purchasing decisions of the buyers. Many goods are purchased by the buyers because of their affection or love for others. For instance, a husband may buy a costly silk saree for his wife or a father buy a costly watch for his son or daughter out of his affection and love.
4. **Comfort or desire for comfort:** Desire for comfort (i.e., comfortable living) is one of the important emotional buying motives. In fact, many products are bought for comfort. For instance, fans, refrigerators, washing machines, cushion beds, etc. are bought by people because of their desire for comfort.
5. **Ambition:** Ambition is one of the emotional buying motives. Ambition refers to the desire to achieve a definite goal. It is because of this buying motive that, sometimes, customers buy certain things.
6. **Desire for distinctiveness or individuality:** Desire for distinctiveness, i.e., desire to be distinct from others, is one of the important emotional buying motives. Sometimes, customers buy certain things, because they want to be in possession of things, which are not possessed by others.



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Purchasing and wearing a particular type of dress by some people is because of their desire for distinctiveness or individuality.

7. **Desire for recreation or pleasure:** Desire for recreation or pleasure is also one of the emotional buying motives. For instance, radios, musical instruments, etc. are bought by people because of their desire for recreation or pleasure.
8. **Hunger and thirst:** Hunger and thirst are also one of the important emotional buying motives. Foodstuffs, drinks, etc. are bought by the people because of this motive.
9. **Habit:** Habit is one of the emotional considerations influencing the purchasing decision of the customers. Many customers buy a particular thing because of habit, (i.e. because they are used to the consumption of the product). For instance, many people purchase cigarettes, liquors, etc. because of sheer habit.

## **B. Rational Product Buying Motives:**

- When a buyer decides to buy a certain thing after careful consideration (i.e. after thinking over the matter consciously and logically), s/he is said to have been influenced by rational product buying motives.
- Rational product buying motives include the following:
  1. **Safety or Security:** Desire for safety or security is an important rational buying motive influencing many purchases. For instance, iron safes or safety lockers are bought by the people because they want to safeguard their cash, jewelries etc., against theft.
  2. **Economy:** Economy, i.e. saving in operating costs, is one of the important



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rational buying motives. For instance, Hero Honda bikes are preferred by the people because of the economy or saving in the operating cost, i.e. petrol costs.

**3. Relatively low price:** Relatively low price is one of the rational buying motives. Most of the buyers compare the prices of competing products and buy things, which are relatively cheaper.

**4. Suitability:** Suitability of the products for the needs is one of the rational buying motives. Intelligent buyers consider the suitability of the products before buying them. For instance, a

buyer, who has a small dining room, naturally, goes in for a small dining table that is suitable,

i.e. that fits in well in the small dining room.

**5. Utility or versatility:** Versatility or the utility of a product refers to that quality of the product, which makes it suitable for a variety of uses. Utility of the product is one of the important rational buying motives. People, often, purchase things that have utility, i.e. that can be put to varied uses.

**6. Durability of the product:** Durability of the product is one of the most important rational buying motives. Many products are bought by the people only on the basis of their durability. For instance, buyers of wooden furniture go in for teak or rosewood table, though they are costlier, as they are more durable than ordinary wooden furniture.

**7. Convenience of the product:** The convenience of the product (i.e. the convenience the product offers to the buyers) is one of the important rational product buying motives. Many products are bought by the people because they are more convenient to them. For instance, automatic watches, gas stoves, etc.,





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are bought by the people because of the convenience provided by them.

### **Patronage Buying Motives:**

- Patronage buying motives refer to those considerations or reasons, which prompt a buyer to buy the product wanted by him from a particular shop in preference to other shops.
- In other words, they are those considerations or reasons, which make a buyer, patronise a particular shop in preference to other shops while buying a product.
- Patronage buying motives also may be sub-divided into two groups viz.  
a) Emotional patronage buying motives and b) Rational patronage buying motives.

#### **A. Emotional Patronage Buying Motives:**

❖ When a buyer patronises a shop (i.e. purchases the things required by him from a particular shop) without applying his mind or without reasoning, he is said to have been influenced by emotional patronage buying motives. Emotional patronage buying motives include the following:

- 1. Appearance of the shop:** Appearance of the shop is one of the important emotional patronage buying motives. Some people make their purchases from a particular shop because of good or attractive appearance of the shop,
- 2. Display of goods in the shop:** Attractive display of goods in the shop also makes the buyers patronise a particular shop.
- 3. Recommendation of others:** Recommendation of others also constitutes



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one of the important emotional patronage buying motives. Some people purchase their requirements from a particular shop because that shop has been recommended to them by others, i.e., by their friends and relatives.

**4. Imitation:** Imitation also is one of the emotional patronage buying motives influencing the purchases of buyers. Some people make their purchases from a particular shop just because other people make their purchases from that shop.

**5. Prestige:** Prestige is one of the emotional patronage buying motives of the buyers. For instance, some people consider it a prestige to take coffee from a five-star hotel.

**6. Habit:** Habit is also one of the important emotional patronage buying motives. Some people make their purchases from a particular shop for the simple reason that they have been habitually making their purchases from that shop.

### **B. Rational Patronage Buying Motives:**

❖ When a buyer patronises a shop after careful consideration (i.e. after much logical reasoning and careful thinking) he is said to have been influenced by rational patronage buying motives. Rational patronage buying motives include the following:

• **Convenience:** Convenient location proximity of a shop is one of the considerations influencing the purchases of many buyers from a particular shop. Many buyers, usually, buy their requirements from a near-by shop, as it is convenient to them to make their purchases. Similarly,



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convenient working hours of the shop also influence the purchases of good many buyers.

- **Low price charged by the shop:** Price charged by the shop also influences the buyers to patronise a particular shop. If the price charged by a shop for a particular product is relatively cheaper, naturally, many people will make their purchases from thatshop.
- **Credit facilities offered:** The credit facilities offered by a store also influence the buying of some people from a particular shop. People who do not have enough money to make cash purchases every time prefer to make their purchases from a shop which offers creditfacilities.
- **Services offered:** The various sales and after-sale services, such as acceptance of orders through phone, home delivery of goods, repair service, etc., offered by a shop also induce the buyers to buy their requirements from that shop. Rational buyers are, often, influenced by the various services or facilities offered by theshop
- **Efficiency of salesmen:** The efficiency of the salesmen employed by a shop also influences the people in patronising a particular shop. If the employees are efficient and are capable of helping the buyers in making their purchases, people naturally would flock to such ashop.
- **Wide choice:** Wide choice of goods offered by a shop is one of the rational considerations making the buyers patronise a particular shop. People generally prefer to make their purchases from a shop, which offers wide choice (i.e. wide varieties of goods).
- **Treatment:** The treatment meted out by a shop to the customers is one of the rational considerations influencing the buyers to patronise a



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particular shop. Usually, people would like to purchase their requirements from a shop where they get courteous treatment.

- **Reputation of the shop:** Reputation of the shop for honest dealings is also one of the rational patronage buying motives. Usually, people would like to make their purchases from a store having reputation for fairdealings.

### **BUYING DECISION PROCESS:**

#### **Meaning of Buying Decision:**

- ❖ The buying decision process is the decision making process used by customers regarding market transactions before, during and after the purchase of goods or services.
- ❖ For example , while the customers are going for shopping and deciding what to eat.

### **STAGES OF BUYING DECISION PROCESS:**

- ❖ The marketer is responsible for selling the goods in the market so he must have the knowledge how the consumers actually make their buying decisions.
- ❖ For this he must study the consumer buying decision process or model. It involves five stages.

**1.) Need recognition:-** consumer buying decision process starts with need recognition. The marketer must recognize the needs of the consumer as well as



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how these needs can be satisfied. For example if a person is hungry then food is desired or if it is a matter of thirst than water is desirable.

**2.) Information search:**– in consumer buying decision process information search comes at second number. In this stage consumer searches the information about the product either from family, friends, neighborhood, advertisements, whole seller, retailers, dealers, or by examining or using the product.

**3.) Evaluation of alternatives:**– after getting the required knowledge about the product the consumer evaluate the various alternatives on the basis of it's want satisfying power, quality and it's features.

**4.) Purchase decision:**– after evaluating the alternatives the buyer buys the suitable product. But there are also the chances to postpone the purchase decision due to some reasons. In that case the marketer must try to find out the reasons and try to remove them either by providing sufficient information to the consumers or by giving them guarantee regarding the product to the consumer.

**5.) Post purchase behaviour:**– after buying the product consumer will either be satisfied or dissatisfied. If the consumer is not satisfied in that case he will be disappointed otherwise If he is satisfied than he will be delighted. It is usually said that a satisfy consumer tell about the product to 3 people and a dissatisfy consumer tell about the product to 11 people. Therefore it is the duty of the marketer to satisfy the consumer.

❖ Thus, these are the five stages of the consumer buying decision process.

### **PARTICIPANTS IN BUYING PROCESS:**

The major participants in

business buying process are:



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- **Initiators**—are the ones who initiate or recognize the need of a particular product requirement in the organization for enhancement or to combat deprivation.
- **Influencers** --Influencers can be of different levels and the decisions that they influence might differ from person to person or post to post. These are basically the people who will influence the decision of which product to buy from where and what suitable price to buy it in.
- **Deciders**—they decide or have the authority to decide whether to buy a certain product or not.
- **Buyers**--They are the ones who make the actual purchases from other business.
- **Users**—are the ones who are going to use the product or require it for the smooth functioning of their operations.



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### UNIT – 4 Marketing Environment and study of competitors

#### What is Marketing Environment?

- Marketing Environment is the combination of external and internal factors and forces which affect the company's ability to establish a relationship and serve its customers.
- The marketing environment of a business consists of an internal and an external environment. The internal environment is company specific and includes owners, workers, machines, materials etc.
- The external environment is further divided into two components: micro & macro. The micro or the task environment is also specific to the business but external.
- It consists of factors engaged in producing, distributing, and promoting the offering. The macro or the broad environment includes larger societal forces which affect society as a whole.
- The broad environment is made up of six components: demographic, economic, physical, technological, political-legal, and social-cultural environment.

#### Components of Marketing Environment

- The marketing environment is made up of the internal and external environment of the business.
- While internal environment can be controlled, the business has very less or no control over the external environment.

#### Internal Environment

- The internal environment of the business includes all the forces and factors inside the organisation which affect its marketing operations.





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(AFFILIATED TO SAURASHTRA UNIVERSITY & GTU)

**3- Vaishalinagar**  
**Nr. Amrapali Railway Crossing**  
**Raiya Road, Rajkot – 360001**  
**Ph. No–(0281)2471645**

**2- Vaishalinagar**  
**Nr. Amrapali Railway**  
**Raiya Road, Rajkot – 360001**  
**Ph.No–(0281)2440478, 2472590**

These components can be grouped under the Five Ms of the business, which are:

- Men
- Money
- Machinery
- Materials
- Markets
- ❖ The internal environment is under the control of the marketer and can be changed with the changing external environment. This environment includes the sales department, marketing department, the manufacturing unit, the human resource department, etc.

### **External Environment**

The external environment constitutes factors and forces which are external to the business and on which the marketer has little or no control. The external environment is of two types:

**Micro Environment:** The micro component of the external environment is also known as the task environment. It comprises of external forces and factors that are directly related to the business. These include suppliers, market intermediaries, customers, partners, competitors and the public.

- **Suppliers** include all the parties which provide resources needed by the organisation.
- **Market intermediaries** include parties involved in distributing the product or service of the organisation.
- **Partners** are all the separate entities like advertising agencies, market



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research organisations, banking and insurance companies, transportation companies, brokers, etc. which conduct business with the organisation.

- **Customers** comprise of the target group of the organisation.
- **Competitors** are the players in the same market who targets similar customers as that of the organisation.
- **Public** is made up of any other group that has an actual or potential interest or affects the company's ability to serve its customers.

## **Macro Environment:**

The macro component of the marketing environment is also known as the broad environment. It constitutes the external factors and forces which affect the industry as a whole but don't have a direct effect on the business. The macro environment can be divided into 6 parts:

***Demographic Environment*** :The demographic environment is made up of the people who constitute the market. It is characterised as the factual investigation and segregation of the population according to their size, density, location, age, gender, race, and occupation.

***Economic Environment*** :The economic environment constitutes factors which influence customers' purchasing power and spending patterns. These factors include the GDP, GNP, interest rates, inflation, income distribution, government funding and subsidies, and other major economic variables.

***Physical Environment***: The physical environment includes the natural environment in which the business operates. This includes the climatic conditions, environmental change, accessibility to water and raw materials, natural disasters, pollution etc.

***Technological Environment*** : The technological environment constitutes innovation, research and development in technology, technological alternatives, innovation inducements also technological barriers to smooth operation.



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Technology is one of the biggest sources of threats and opportunities for the organisation and it is very dynamic.

***Political-Legal Environment:*** The political & Legal environment includes laws and government's policies prevailing in the country. It also includes other pressure groups and agencies which influence or limit the working of industry and/or the business in the society.

***Social-Cultural Environment :*** The social-cultural aspect of the macro environment is made up of the lifestyle, values, culture, prejudice and beliefs of the people. This differs in different regions.

### **Features Of Marketing Environment**

The marketing environment surrounding a business possesses the following five features:

- **Specific and general forces:** The marketing environment is made up of both specific and general forces. Specific forces such as customers and investors directly affect the business's working, while general forces like social, legal, technological, or political factors indirectly affect the business's working.
- **Complex:** The marketing environment is a complex interaction of several elements, factors, conditions, and forces that affect the business's ability to establish a relationship and serve its customers.
- **Dynamic:** The environment surrounding a business is very dynamic as its constituents do not remain stable and change over time. Moreover, while marketers can control some of the marketing environment elements, several elements are out of the marketer's control.
- **Uncertain:** Forces that rule the marketing environment are highly uncertain, and it becomes tough for a marketer to predict market forces to develop marketing strategies and plans.
- **Relative:** Marketing environments are also relative in nature. A specific product might have a good demand in the USA but not in India because of the different marketing environments in the two countries.



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## **Importance of Marketing Environment:**

Every business, no matter how big or small, operates within the marketing environment. Its present and future existence, profits, image, and positioning depend on its internal and external environment. The business environment is one of the most dynamic aspects of the business. In order to operate and stay in the market for long, one has to understand and analyse the marketing environment and its components properly.

### **Essential for planning**

An understanding of the external and internal environment is essential for planning for the future. A marketer needs to be fully aware of the current scenario, dynamism, and future predictions of the marketing environment if he wants his plans to succeed.

### **Understanding Customers**

Thorough knowledge of the marketing environment helps marketers acknowledge and predict what the customer actually wants. In-depth analysis of the marketing environment reduces (and even removes) the noise between the marketer and customers and helps the marketer to understand consumer behaviour better.

### **Tapping Trends**

Breaking into new markets and capitalising on new trends requires a lot of insight into the marketing environment. The marketer needs to research about every aspect of the environment to create a foolproof plan.

### **Threats and Opportunities**

Sound knowledge of the market environment often gives a first-mover advantage to the marketer as he makes sure that his business is safe from future threats and taps the future opportunities.



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## **Understanding the Competitors**

Every niche has different players fighting for the same spot. A better understanding of the marketing environment allows the marketer to understand more about the competitions and about what advantages do the competitors have over his business and vice versa.

## **Limitations or Disadvantages of Marketing Environment:**

Environmental analysis suffers from certain limitations also. These limitations are as follows:

### **1. Lack of Forewarning of Unforeseen Events**

- Environmental analysis does not predict the future. It does not eliminate uncertainty for the organization also. Business enterprises sometimes face events, which are unexpected during analysis. Environmental analysis, however, should aim at minimizing the frequency and extent of surprises that may attack a business organization.

### **2. No Assurance as to Organization Effectiveness**

- Environmental analysis does not ensure organizational effectiveness. It acts only as inputs in strategy development and testing. Sometimes, managers place uncritical faith in the data without thinking about the data's verifiability or accuracy. If this is the case, it may lead to misleading outcome.

### **3. Not fully Reliable**

- Normally, people place too much reliance on the information collected through environmental scanning. But in practice, it is not so. When there is overloading of information, one is likely to get confused.

### **4. Absence of Strategic Approach**

- Success of any organization lies in adventure and strategic risk-taking. Environmental analysis often makes an individual too cautious in his approach and he is likely to be left behind the events. So this analysis should be strategically done.



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### EXPLAIN THE CONCEPT OF ANALYSING COMPETITORS.

#### **Introduction :**

The market scenario presently is such that just knowing consumer needs and wants alone, may not lead a marketer to profitability, the reason being that there are many others in the market who strive to deliver value to the customers. For a marketer to do well he also needs to observe and understand what his competitors are doing. Today's market scenario is of high competition and hence to do well it is important to analyse the competition. Companies need to develop strategies that will help them proactively respond to market opportunities faster than the competitors.



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Competition in an industry is determined not only by the existing competitors but also by other forces such as customers, suppliers, potential entrants, and substitute products. These forces were first identified by Michael Porter at the Harvard Business School and the framework is popularly known as “The Five Force Model”. The five forces are:

### **Suppliers :**

Suppliers mainly mean the suppliers of raw materials and other inputs in the process of making a product. The bargaining power of suppliers is an important factor in two ways, one if the supplier changes his pricing it will change the pricing of the final product and reduce the competitive advantage for a marketer. Secondly, if the supplier integrates his business forward he might in the future become a competitor to the marketer.

### **Buyers :**

The bargaining power of a buyer in an industry can determine how competitive a marketer can be. If the bargaining power of a buyer is high, which, normally happens when there is high competition in the market, it will reduce the profit margins of the marketer if the buyer has many options to purchase from.

### **Entry barrier :**

Entering every industry is not an easy task, there are some industries where the government issues licences and puts barriers on the number of operators in an industry.

### **Substitutes :**

Substitutes are products which are different but satisfy the same need. For example mobile and e-mails are different products but satisfying the same need of communication, or tea and coffee are generic different products but satisfy similar needs.

### **Existing competition :**

The intensity of the competition prevailing in an industry should be closely analysed before a marketer enters a particular industry. An industry with





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high intensity of competition or with cut-throat competition will not lead a marketer to profitability.

### **Process of analyzing competition :**

Organisations need to analyse competition in a systematic and a structured manner. The best way to analyse competition is to know who the existing competitors are and who the competitors will be in the near future, say, five years down the line.

The steps to analyzing competition would be as follows :

- A. Identifying competition.
- B. Assessing competition
- C. Designing competitive strategies.

### **A. Identifying competition :**

Depending on the products and services offered by an organization it is easy to identify its competitors. Few of the things that a company needs to keep track of the new entrants to the industry and the latest technologies used in the production.

To identify the competitors better it is important to classify the competitors by the nature of competition they pose to a particular product. These categories of competitors could be classified as follows :

### **Industry competition :**

Industry competitors are companies that produce the same kind of products.

### **Brand competition :**

Brand competition is different from industry competition because Brand competition normally happens at a more micro level within an industry. When in a segmented market, two or more companies introduce their products in the market to compete within the same segment. For example, Hero Honda Splendour and Bajaj Boxer are Brand competitors.



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### **Form competition :**

These may be products of different forms that satisfy the same need or in other words the customer seeks to derive the same kind of benefit from the offering made by the products.

### **Generic competition :**

Generic competitors are ones which a marketer must very intelligently observe and analyse. They normally tend to target the disposable income of the customer. For example, Hero Honda motorcycles and L Gair-conditioners. Literally speaking they are not competitors, but a customer with a limited source of income will ideally be able to afford only one at a time depending on the priority of his need, which means if he buys an air conditioner he will have to postpone the purchase of motorcycle. Hence, though motorcycles and air-conditioners have nothing in common they still become competitors as they target the same disposable income of the customer.

### **Assessing competition :**

Once a marketer has identified his competitors in all different ways, he needs to assess each closely so as to specifically frame strategies that can lead him to success and profitability.

To assess the competition a marketer needs to very closely analyse a few factors about the competitors, they are as follows:

### **Objectives :**

Objectives tend to define what an organization tries to achieve. Normally every organization tends to follow a mix of objectives these could be profitability, market share growth, cash flow, technological leadership. Service leadership or some other such objective.

### **Strategies :**

Assessing the strategies of the competitors give a marketer a lot of idea about what the competitor is doing in the marketplace. Some competitors follow slow strategies while there are others who are aggressive in the market. Knowing the competitor strategies gives the marketer enough insight to formulate his own strategies in accordance with the competition.



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For example, in the soap industry if one of the market players realizes the growing demand of herbal products, he launches a new herbal soap. If that herbal soap starts doing well in the market, it gives strong signals to the other competitors in the market of changing consumer trends and the opportunities created by.

### **Strengths and weaknesses :**

There is no better way to assess an individual or a company and to do a SWOT analysis. Opportunities and threats are normally created by the environment and hence would be common to all the players in the market. But, strengths and weaknesses are individual. Analysing the strengths and weaknesses of the competitor gives a marketer a fair idea about what the competitor is capable of doing or not doing.

### **Reaction patterns :**

Each competitor reacts differently. Some do not react quickly or strongly to a competitors move, as they may feel that their customers are loyal. While some companies react quickly to the moves made by their competitors. The competitor's reaction patterns to a firms' competitor strategies should be observed continuously, because it is necessary to attack the competitors in their weak areas. For example, when sensodine toothpaste launched in the market with a specific characteristic of curing aching teeth. The toothpaste was acknowledged by the customers and it started gaining strength in the market. Colgate was quick to react and launch a similar toothpaste in the market.

### **Designing Competitive Strategies :**

Once a company has identified and assessed its major competitors, it must now design effective competitive marketing strategies to gain competitive advantage and offer superior value to its customers. Some of the strategies that can be used by marketers in the marketplace are as follows :

### **Market Leader Strategies :**

Most industries normally have a market leader. These leaders are companies with the largest market share and usually lead the other firms in price changes, new product introductions, distribution coverage, and promotion



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spending. A leader may not always be admired respected by the other firms in the market, but they only compromise to its dominance. When an industry has a defined marketing leader the other firms in the industry either try to challenge, follow or altogether avoid the leader. As far as the Indian markets are concerned some of the well-known market leaders are Maruti Suzuki (automobiles), Gillette (razors and blades), Colgate-Palmolie (toothpaste), Coca-Cola (cola soft drinks), Hero Honda (motorcycles) and many others.

For example, Hero Honda possesses almost half the market share as far as motorcycle industry in India is concerned and to maintain this leadership they conduct continuous advertising and promotion campaigns and come up with newer models of motorcycles and continuously keep innovating and adding features to their edexisting products. This increases their competitiveness and helps them maintain their market leadership.

### **Market Challenger Strategy :**

Market challengers are those firms who fall just below the market leader as far as the market hierarchy is concerned. These runner-up firms can adapt one or two competitive strategies; they can challenge the market leader and other competitors in an aggressive way for more market share or they may except what the market leader is doing and follow them.

For example, HLL and Procter & Gamble are market leaders as far as washing powder industries concerned, but their presence in the rural India is very weak. Nirma realize this opportunity and strongly penetrated into the rural markets of India in the detergent industry. Today Nirma stands with the largest market share in rural India.

### **Market Follower Strategy :**

Market followers prefer to follow the leader rather than attack it unlike the challengers. Most market followers prefer to follow the leader as far as product innovations, marketing strategies, prancing and advertising are concerned. In other words they try to imitate the leader in all aspects.

For example, when mobile services first launched in India, Nokia for a very long time remained the market leader in the handsets segment. It always



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tried to come out with new products by adding innovative features to its handsets. Other handset companies like Samsung, LG, Motorola etc. only replicated their handset models and launch them in the market at a price a little lower than Nokia. Today most of these followers stand with almost an equal market share as Nokia and give it a tough competition in the market.

### **Market Niche Strategy :**

A ‘niche’ means a very small segment in the entire market. And nichers are those marketers who try to cover this niche and make it their own. A niche strategy is a very interesting one, as a niche marketer stands as a leader as far as that small segment is concerned. Most of the times such niche segments are not large enough to attract big players in the industry, and so it gives the niche that additional cushion in the marketplace. For example, the Royal Enfield motorcycle company produces and markets heavy cruiser motorcycles. This segment as compared to the entire motorcycle industry in India is very small and so it does not attract the larger players like Hero Honda, Bajaj or TS to the segment. Hence this segment gives Royal Enfield protection against competition

### **DISCUSS ON ONLINE MARKETING.**

- Online marketing is a set of tools and methodologies used for promoting products and services through the internet. Online marketing includes a wider range of marketing elements than traditional business marketing due to the extra channels and marketing mechanisms available on the internet.
- Online marketing is also known as internet marketing, web marketing, or digital marketing. It includes several branches such as social media marketing (SMM), search engine optimization (SEO), pay-per-click advertising (PPC), and search engine marketing (SEM).



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## **Advantages of online marketing:**

### **1. Global reach**

Internet marketing provides businesses with a wide base of customers for their services or products. With the internet, all types of businesses, from multinationals to small and medium enterprises, have access to millions of prospective customers. Your adverts are seen by many customers through the advertising tools that you use. The greater the number of users that visit your page, the higher the sales that you will make.

### **2. 24/7 marketing**

With online marketing campaigns, one will be advertising their business 24 hours every day. Furthermore, you will not have to worry about staff wages or store hours. Additionally, the time variations in the different parts of the world will not affect your campaigns. Your target customers can access your website and purchase goods and services irrespective of the time or fear of closing hours.

### **3. Low cost**

In any marketing campaign, cost is a key factor that must be considered as it affects the company's budget. Businesses can avoid the high cost of marketing that is associated with traditional forms of advertising by embracing internet marketing and blogging. Internet marketing is way cheaper than television and radio ads and creating and mounting billboards. Marketing through your blog is one of the ways you can sell effectively online.

### **4. Social media**

Social media plays a crucial role in modern advertising. This is because customers look at comments and reviews posted by other consumers online. Businesses can easily incorporate social network tools in their advertising campaigns and make profits from customers that rely heavily on social media.





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## **5. Builds lasting relationships**

As long as your business has an online presence, your customers will always find you. With internet marketing, suppliers can easily access the email addresses or contacts of both the prospects and the buyers. Businesses can use this information to send updates to their customers regarding special discounts, new products or services, new coupons and products available. Furthermore, businesses can continue interacting with their clients after the sale.

## **6. Ease of personalization**

Electronic marketing enables businesses to tailor their advertising techniques to suit the needs of their target audience. Businesses can also personalize communication between them and their clients. This ensures that your service or product will reach your prospects in a timely manner. Furthermore, it strengthens the brand image and presence of the company.

## **7. Blogging provides quality content**

Content reigns on the internet and it attracts natural links. If the content of your blogs is good, other people will want to refer to it and this will attract people to your website. Make sure that your website is consistently flowing with fresh, educative and relevant information that your users are looking for.

Today, there is an increase in the number of consumers who buy products and services online. As a result, more and more companies globally are now resorting to internet marketing to connect with their customers and advertise their products and services. This sets them apart from their competitors and it helps them to increase their profit margins.





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### **Disadvantages of online marketing:**

Some of the downsides and challenges of digital marketing you should be aware of include:

- **Skills and training** - You will need to ensure that your staff have the right knowledge and expertise to carry out digital marketing with success. Tools, platforms and trends change rapidly and it's vital that you keep up-to-date.
- **Time consuming** - tasks such as optimising online advertising campaigns and creating marketing content can take up a lot of time. It's important to measure your results to ensure a return-on-investment.
- **High competition** - while you can reach a global audience with digital marketing, you are also up against global competition. It can be a challenge to stand out against competitors and to grab attention among the many messages aimed at consumers online.
- **Complaints and feedback** - any negative feedback or criticism of your brand is can be visible to your audience through social media and review websites. Carrying out effective customer service online can be challenging. Negative comments or failure to respond effectively can damage your brand reputation.
- **Security and privacy issues** - there are a number of legal considerations around collecting and using customer data for digital marketing purposes. Take care to comply with the rules regarding privacy and data protection.

### **PROCESS OF ONLINE MARKETING:**

Before developing website/mobile apps, marketer has to do careful planning otherwise the entire expenditure may be totally wasted. Following are the step by step analysis to plan and implement online marketing process:

**1) Define Objectives:** At first stage, marketer needs to be clear that, why he need internet support, what are the objectives fulfilled through internet. Whether consumer actually needs online presence: how it will be beneficial in promoting product/service as well as sales and market etc. this will help the marketer to design his online marketing plan.

**2) Design on Internet Marketing plan:** At this stage, marketer has to design an internet marketing plan, marketer needs to careful analysis of marketing



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environment, competitors' analysis, SWOT Analysis, USP to sustain in the competition.

**3) Design a web address:** In order to design website/apps, very first thing is to decide a domain name. By this domain name of the website name/address then the visitors search our site through web browsers. For making business website, domain name should be with your company's name. For example [www.ril.ac.in](http://www.ril.ac.in) (Reliance Industries limited).

**4) Designing the web layout:** After designing a web address new marketer needs to design his web layout on the website. For example marketer includes content like Home, About us, Contact us, FAQ, Services, photographs, Videos, specifications, PDF etc..

**5) Tracking and profiling visitors:** after Designing web layout for website, marketer should also design tracking tools to learn the visitors, their behaviors, attitudes etc. so that necessary changes can be done time to time. It gives analysis of how many visitors visit the website in a day?, what content they visit?, geographical location of visitors, how many visitors buy the products? Etc....

**6) Tie up with search Engines and mobile app store:** today yahoo, Google is used by people for searching any information. so marketer has to present his website on search engine too. So the large number of people can take the benefit of it.

**7) Promotion of your websites:** After tie up with search engine and mobile app store next step is to promote your website/app in different medias like TV, Newspaper, hoardings, calendar, magazine etc ....

**8) Upgrading Website/App on Regular basis:** After promotion, marketer has to regularly update his website/app with new features, attractive layout, videos, pictures, colour, and information etc...as per the demand of customer.



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Nr. Amrapali Railway Crossing  
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Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

### B.B.A. SEM -3

## Financial Management

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### UNIT – 1(A)

## Introduction to Financial Management

### INTRODUCTION

Finance is regarded as the life blood of a business enterprise. This is because in the modern money-oriented economy, finance is one of the basic foundations of all kinds of economic activities. Long considered a part of economics, corporation finance emerged as a separate field of study in the early part of 20th century. At first it dealt with only the instruments, institutions, and procedural aspects of capital markets. Accounting data and financial records were not the kind we use today, nor were regulations making it necessary to disclose financial data. But interest in financial innovations, promotions, consolidations, and mergers has always been increasing.

In a modern company's development, the financial manager plays a dynamic role. Besides records, reports, the firm's cash position, and obtaining funds, the financial manager is concerned with (1) investing funds in short-term as well as in long-term assets and (2) obtaining the best mix of financing and dividends in relation to the overall solution of the firm. All of this demands a broad outlook and an alert creativity that will influence almost all facts of the enterprise and its external environment.

### OBJECTIVE OF FINANCIAL MANAGEMENT

To put it simply, we might say that the goal of any business is to maximise the returns to the owners of the business. So the goal of finance is to help the business in maximising returns. But if you talk to the companies, you also hear about many other goals that they are pursuing at the same time. These goals could include maximisation of sales, maximisation of market share, maximisation of growth rates of sales, maximisation of the market price of the share (whether real or specifically pushed up to benefit the owners), etc. Individually speaking, managers would be more concerned with the money that they are making from the organisation and the benefits that they are receiving rather than care about what the owners are making!

As there could be many goals for the organisation, we should try and summarise the organisational goals in financial terms so that we can call them the financial goals. They boil down to two:

1. Maximise profits
2. Maximise wealth.

### Maximise Profits



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Let us first look at profit maximisation. Profit (also called net income or earnings) can be defined as the amount a business earns after subtracting all expenses necessary for its sales. To put it in an equation form:

Sales - Expenses = Profit

If you want to maximise profits, there are only two ways to do it. Either you reduce your expenses (also called costs) or you increase the sales (also called revenues). Both of these are not easy to achieve. Sales can be increased by selling more products or by increasing the price of the products. Selling more products is difficult because of the competition in the market and you cannot increase the price of the products without adding more features or value to it (assuming a competitive market). If you are a competitive company, reducing expenses beyond a certain level is possible only by reducing the investments in advertising, research and development, etc. which ultimately leads to reduction in sales in the long term and threatens the survival of the company. Profit maximisation goal assumes that many of the complexities of the real world do not exist and is, therefore, not acceptable.

Still, profit maximisation remains one of the key goals for the managers of the company because many managers' compensations are linked to the profits that the company is generating. Owners need to be aware of these goals and understand that it is the long term viability of their companies that add value to them and not the short-term profitability.

Therefore, the long-term survival of the company should not be sacrificed for the short term benefits.

### **Wealth Maximisation**

Shareholders' wealth can be defined as the total market value of all the equity shares of the company. So when we talk about maximising wealth we talk about maximising the value of each share.

The shareholders' wealth maximisation goal gives us the best results because effects of all the decisions taken by the company and its managers are reflected in it. In order to employ this goal, we do not have to consider every price change of our shares in the market as an interpretation of the worth of the decisions that the company has taken. What the company needs to focus on is the affect that its decision should have on the share price if everything else was held constant. This conflict of the decisions by the managers and the decisions required by the owners is known as the agency problem. How are companies solving this problem will be discussed later.



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### **IMPORTANCE OF FINANCIAL MANAGEMENT CYCLE:**

Finance is the lifeblood of business organization. It needs to meet the requirement of the business concern. Each and every business concern must maintain adequate amount of finance for their smooth running of the business concern and also maintain the business carefully to achieve the goal of the business concern. The business goal can be achieved only with the help of effective management of finance. We can't neglect the importance of finance at any time at and at any situation. Some of the importance of the financial management is as follows:

#### **Financial Planning**

Financial management helps to determine the financial requirement of the business concern and leads to take financial planning of the concern. Financial planning is an important part of the business concern, which helps to promotion of an enterprise

#### **Acquisition of Funds**

Financial management involves the acquisition of required finance to the business concern. Acquiring needed funds play a major part of the financial management, which involve possible source of finance at minimum cost.

#### **Proper Use of Funds**

Proper use and allocation of funds leads to improve the operational efficiency of the business concern. When the finance manager uses the funds properly, they can reduce the cost of capital and increase the value of the firm.

#### **Financial Decision**

Financial management helps to take sound financial decision in the business concern. Financial decision will affect the entire business operation of the concern. Because there is a direct relationship with various department functions such as marketing, production personnel, etc.

#### **Improve Profitability**

Profitability of the concern purely depends on the effectiveness and proper utilization of funds by the business concern. Financial management helps to improve the profitability position of the concern with the help of strong financial control devices such as budgetary control, ratio analysis and cost volume profit analysis.





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### Increase the Value of the Firm

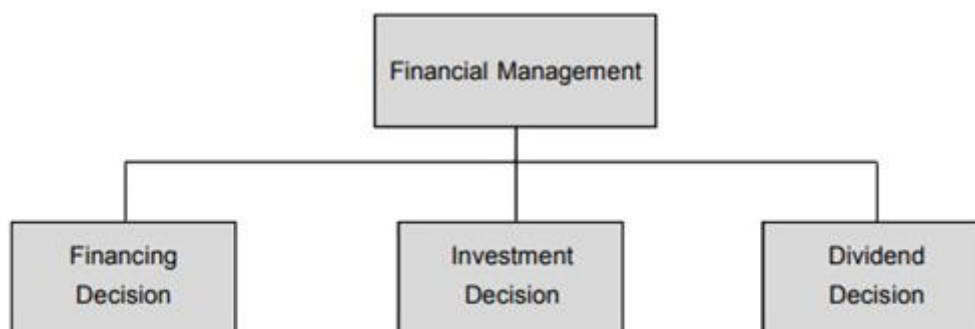
Financial management is very important in the field of increasing the wealth of the investors and the business concern. Ultimate aim of any business concern will achieve the maximum profit and higher profitability leads to maximize the wealth of the investors as well as the nation.

### Promoting Savings

Savings are possible only when the business concern earns higher profitability and maximizing wealth. Effective financial management helps to promoting and mobilizing individual and corporate savings.

Now days financial management is also popularly known as business finance or corporate finances. The business concern or corporate sectors cannot function without the importance of the financial management.

## FINANCIAL FUNCTION



You can understand the nature of financial management by studying the nature of investment, financing, and dividend decisions.

**Investment Decisions:** Managers need to decide on the amount of investment available out of the existing finance, on a long-term and short-term basis. They are of two types:

- Long-term investment decisions or Capital Budgeting mean committing funds for a long period of time like fixed assets. These decisions are irreversible and usually include the ones pertaining to investing in a building and/or land, acquiring new plants/machinery or





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replacing the old ones, etc. These decisions determine the financial pursuits and performance of a business.

- Short-term investment decisions or Working Capital Management means committing funds for a short period of time like current assets. These involve decisions pertaining to the investment of funds in the inventory, cash, bank deposits, and other short-term investments. They directly affect the liquidity and performance of the business.

**Financing Decisions:** Managers also make decisions pertaining to raising finance from long-term sources (called Capital Structure) and short-term sources (called Working Capital). They are of two types:

- **Financial Planning decisions** which relate to estimating the sources and application of funds. It means pre-estimating financial needs of an organization to ensure the availability of adequate finance. The primary objective of financial planning is to plan and ensure that the funds are available as and when required.
- **Capital Structure decisions** which involve identifying sources of funds. They also involve decisions with respect to choosing external sources like issuing shares, bonds, borrowing from banks or internal sources like retained earnings for raising funds.

**Dividend Decisions:** These involve decisions related to the portion of profits that will be distributed as dividend. Shareholders always demand a higher dividend, while the management would want to retain profits for business needs. Hence, this is a complex managerial decision.

### SCOPE OF FINANCIAL MANAGEMENT

Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing and production. Financial management covers wide area with multidimensional approaches. The following are the important scope of financial management.

#### 1. Financial Management and Economics

Economic concepts like micro and macroeconomics are directly applied with the financial management approaches. Investment decisions, micro and macro environmental factors are closely associated with the functions of financial manager. Financial management also uses the economic equations like money value discount factor, economic order quantity etc. Financial economics is one of the emerging area, which provides immense opportunities to finance, and economical areas.



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### 2. Financial Management and Accounting

Accounting records includes the financial information of the business concern. Hence, we can easily understand the relationship between the financial management and accounting. In the olden periods, both financial management and accounting are treated as a same discipline and then it has been merged as Management Accounting because this part is very much helpful to finance manager to take decisions. But now a day's financial management and accounting discipline are separate and interrelated.

### 3. Financial Management or Mathematics

Modern approaches of the financial management applied large number of mathematical and statistical tools and techniques. They are also called as econometrics. Economic order quantity, discount factor, time value of money, present value of money, cost of capital, capital structure theories, dividend theories, ratio analysis and working capital analysis are used as mathematical and statistical tools and techniques in the field of financial management.

### 4. Financial Management and Production Management

Production management is the operational part of the business concern, which helps to multiple the money into profit. Profit of the concern depends upon the production performance. Production performance needs finance, because production department requires raw material, machinery, wages, operating expenses etc. These expenditures are decided and estimated by the financial department and the finance manager allocates the appropriate finance to production department. The financial manager must be aware of the operational process and finance required for each process of production activities.

### 5. Financial Management and Marketing

Produced goods are sold in the market with innovative and modern approaches. For this, the marketing department needs finance to meet their requirements. The financial manager or finance department is responsible to allocate the adequate finance to the marketing department. Hence, marketing and financial management are interrelated and depends on each other.

### 6. Financial Management and Human Resource

Financial management is also related with human resource department, which provides an power to all the functional areas of the management. Financial manager should carefully evaluate the requirement of manpower to each department and allocate the finance to the human resource department as wages, salary, remuneration, commission, bonus, pension and other



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monetary benefits to the human resource department. Hence, financial management is directly related with human resource management.

### APPROACHES OF FINANCIAL FUNCTION

A number of approaches are associated with finance function but for the sake of convenience, various approaches are divided into two broad categories:

1. The Traditional Approach
2. The Modern Approach

#### 1. The Traditional Approach

Financial management is primarily concerned with acquisition, financing and management of assets of business concern in order to maximize the wealth of the firm for its owners. The basic responsibility of the Finance manager is to acquire funds needed by the firm and investing those funds in profitable ventures that will maximize firm's wealth, as well as, yielding returns to the business concern.

The success or failure of any firm is mainly linked with the quality of financial decisions. The focus of Financial management is on efficient and judicious use of resources to attain the desired objective of the firm.

The basic objectives of Financial management centres around (a) the procurement funds from various sources like equity share capital, preference share capital, debentures, term loans, working capital finance, and (b) effective utilization of funds to maximize the profitability of the firm and the wealth of its owners.

The responsibilities of the Finance managers are linked to the goals of ensuring liquidity, profitability or both and are also related to the management of assets and funds of any business enterprise.

The traditional view of financial management looks into the following functions, that a Finance manager of a business firm will perform:

- (a) Arrangement of short term and long-term funds from financial institutions.
- (b) Mobilization of funds through financial instruments like equity shares, preference shares, debentures, bonds etc.



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(c) Orientation of finance function with the accounting function and compliance of legal provisions relating to funds procurement, use and distribution.

With the increase in complexity of modern business situation, the role of a Finance manager is not just confined to procurement of funds, but his area of functioning is extended to judicious and efficient use of funds available to the firm, keeping in view the objectives of the firm and expectations of the providers of funds.

### 2. The Modern Approach

The globalization and liberalization of world economy has caused to bring a tremendous reforms in financial sector which aims at promoting diversified, efficient and competitive financial system in the country. The financial reforms coupled with diffusion of information technology has caused to increase competition, mergers, takeovers, cost management, quality improvement, financial discipline etc.

Globalization has caused to integrate the national economy with the world economy and it has created a new financial environment which brings new opportunities and challenges to the individual business concern. This has led to total reformation of the finance function and its responsibilities in the organization.

Financial management in India has changed substantially in scope and complexity in view of recent Government policy. Today's Finance managers are seized with problems of financial distress and are trying to overcome it by innovative means. In the current economic scenario, financial management has assumed much greater significance.

It is now a question of survival of entities in the total spectrum of economic activity, with pragmatic readjustment of financial management. The information age has given a fresh perspective on the role of financial management and Finance managers. With the shift in paradigm it is imperative that the role of Chief Finance Officer (CFO) changes from Controller to a Facilitator.

In view of modern approach, the Finance manager is expected to analyse the firm and to determine the following:

- (i) The total funds requirement of the firm,
- (ii) The assets to be acquired, and
- (iii) The pattern of financing the assets.



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### TOOLS AND TECHNIQUES OF FINANCIAL MANAGEMENT

The important techniques of financial management are summarized as follows:-

#### 1. Common-Size Statements:

The common-size financial statements are those in which figures reported are converted into percentage to some common base. Common-size balance sheet and income statement are prepared for vertical analysis and interpretation is done for identification of causes for changes taken place over a period of time.

The items in the financial statements are presented as percentages or ratios to total of items and a common base for comparison is provided. Each percentage shows the relation of the individual item to its respective total.

#### 2. Trend Ratios:

Trend ratios are the index numbers of the movements of financial figures reported in the financial statements for more than one accounting period.

It is a statistical technique adopted to reveal the trend of financial items which are used in analysis of behaviour of financial items and for preparation of projected financial statements. In preparation of trend ratios, the base accounting period should be selected and the financial figures of that base period should be given the index number of 100.

The trend ratios are calculated for the subsequent accounting periods taking the base period trend ratio as 100. The trend percentages are calculated for select major financial items in the financial statements to arrive at the conclusions for important changes.

#### 3. Funds Flow Analysis:

The funds flow analysis gives the details of changes in financial position of a concern between two balance sheet dates. It is based on net working capital concept which is termed as 'fund'. The funds flow statement contains the details of financial resources which have become available during the accounting period and the ways in which those resources have been used up.



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The flow of funds refers to movement of funds which cause a change in working capital of the organization. The net increase or decrease in working capital will be further analyzed through preparation of Statement of changes in working capital position. Funds flow statement is a parameter for testing of the effective use of working capital. The analysis is particularly useful for long range planning where projections of liquid resources are vital.

#### 4. Cash-Flow Analysis:

The preparation of cash-flow statements has been made mandatory. A statement of cash-flow reports the cash receipts and cash payments and net changes in cash resulting from operating, investing and financing activities of an enterprise during the period.

The cash-flow statement reconciles the opening and closing balances of cash and cash equivalents for the reported accounting period. It reports a net cash inflow or outflow for each activity and for the overall business.

#### 5. Ratio Analysis:

Ratio analysis is used as an important tool in analysis of financial statements. Ratios are used as an index or yardstick for evaluating the financial position and performance of a firm. Ratio is the expression of one figure in terms of another. It is the expression of the relationship between mutually independent figures. Ratio analysis used financial report and data and summarizes the key relationship in order to appraise financial performance.

It helps the analysts to make quantitative judgment about the financial position and performance of the firm. There are various ratios which are used by different parties for different purposes and can be calculated from the information given in financial statements. The comparison of past ratios with future ratios shows the firm's relative strength and weaknesses.

#### 6. Working Capital Management:

In the efficient working capital management, some of the techniques like economic order quantity, ABC analysis, fixation of inventory levels, cash management models are adopted.

#### 7. Capital Structure:





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The Finance manager has to decide an optimum capital structure to maximize the wealth of shareholders. In capital structure decisions – analysis of operating and financial leverages, cost of different components of capital, EPS – EBIT analysis, ascertainment of EPS of different financing alternatives, determination of financial break-even point, indifference point analysis and other mathematical models are used.

### 8. Capital Budgeting Techniques:

Investment in long-term assets for increasing the revenue of firm is called as ‘capital budgeting’. It is a decision to invest funds in long-term activities for future benefits that increase the wealth of the firm thereby increase the wealth of owners. Capital budgeting refers to long-term planning for proposed capital outlays and their financing.

The future growth of a firm depends on capital expenditure decisions. Capital budgeting involves large amount of funds, risk and uncertainty and they are of an irreversible nature. Estimation of cash-flow is very important for evaluating the investment proposals. Capital budgeting results the exchange of current fund for future benefits which will occur over a series of years to come.

## UNIT – 1(B) TIME VALUE OF MONEY

### Definition

Time Value of Money is a concept that recognizes the relevant worth of future cash flows arising as a result of financial decisions by considering the opportunity cost of funds.

### Concept

Money loses its value over time which makes it more desirable to have it now rather than later. There are several reasons why money loses value over time. Most obviously, there is inflation which reduces the buying power of money.

But quite often, the cost of receiving money in the future rather than now will be greater than just the loss in its real value on account of inflation. The opportunity cost of not having the money right now also includes the loss of additional income that you could have earned simply





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by having received the cash earlier. Moreover, receiving money in the future rather than now may involve some risk and uncertainty regarding its recovery. For these reasons, future cash flows are worth less than the present cash flows.

Time Value of Money concept attempts to incorporate the above considerations into financial decisions by facilitating an objective evaluation of cash flows from different time periods by converting them into present value or future value equivalents. This ensures the comparison of 'like with like'.

The present or future value of cash flows are calculated using a discount rate (also known as cost of capital, WACC and required rate of return) that is determined on the basis of several factors such as:

- **Rate of inflation**

Higher the rate of inflation, higher the return that investors would require on their investment.

- **Interest Rates**

Higher the interest rates on deposits and debt securities, greater the loss of interest income on future cash inflows causing investors to demand a higher return on investment.

- **Risk Premium**

Greater the risk associated with future cash flows of an investment, higher the rate of return required by an investors to compensate for the additional risk.

### **Why is the Time Value of Money Important?**

The time value of money is a concept integral to all parts of business. A business does not want to know just what an investment is worth to day it wants to know the total value of the investment. What is the investment worth in total? Let's take a look at a couple of examples. Suppose you are one of the lucky people to win the lottery. You are given two options on how to receive the money.

1. Option 1: Take Rs 5,00,000 right now.
2. Option 2: Get paid Rs 6,00,000 every year for the next 10 years.



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In option 1, you get Rs 50,00,000 and in option 2 you get Rs 60,00,000. Option 2 may seem like the better bet because you get an extra Rs 10,00,000, but the time value of money theory says that since some of the money is paid to you in the future, it is worth less.

By figuring out how much option 2 is worth today (through a process called discounting), you'll be able to make an apples-to-apples comparison between the two options. If option 2 turns out to be worth less than Rs. 50,00,000 today, you should choose option 1, or vice versa.

Let's look at another example. Suppose you go to the bank and deposit Rs.100. Bank 1 says that if you promise not to withdraw the money for 5 years, they'll pay you an interest rate of 5% a year. Before you sign up, consider that there is a cost to you for not having access to your money for 5 years. At the end of 5 years, Bank 1 will give you back \$128. But you also know that you can go to Bank 2 and get a guaranteed 6% interest rate, so your money is actually worth 6% a year for every year you don't have it. Converting our present cash worth into future value using the two different interest rates offered by Banks 1 and 2, we see that putting our money in Bank 1 gives us roughly Rs.128 in 5 years, while Bank 2's interest rate gives Rs.134. Between these two options, Bank 2 is the better deal for maximizing future value.

### **Relevance of time value of money in financial decision making**

A finance manager is required to make decisions on investment, financing and dividend in view of the company's objectives. The decisions as purchase of assets or procurement of funds i.e. the investment/financing decisions affect the cash flow in different time periods. Cash outflows would be at one point of time and inflow at some other point of time, hence, they are not comparable due to the change in rupee value of money. They can be made comparable by introducing the interest factor. In the theory of finance, the interest factor is one of the crucial and exclusive concept, known as the time value of money.

Time value of money means that worth of a rupee received today is different from the same received in future. The preference for money now as compared to future is known as time preference of money. The concept is applicable to both individuals and business houses. Reasons of time preference of money :

#### **1) Risk :**

There is uncertainty about the receipt of money in future.

#### **2) Preference for present consumption :**



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Most of the persons and companies have a preference for present consumption may be due to urgency of need.

### 3) Investment opportunities :

Most of the persons and companies have preference for present money because of availabilities of opportunities of investment for earning additional cash flows.

### Importance of time value of money :

The concept of time value of money helps in arriving at the comparable value of the different rupee amount arising at different points of time into equivalent values of a particular point of time, present or future. The cash flows arising at different points of time can be made comparable by using any one of the following:

- by compounding the present money to a future date i.e. by finding out the value of present money.
- by discounting the future money to present date i.e. by finding out the present value(PV) of future money.

### 1) Techniques of compounding :

#### i) Future value (FV) of a single cash flow :

The future value of a single cash flow is defined as :

$$FV = PV (1 + r)^n$$

Where, FV = future value

PV = Present value

r = rate of interest per annum

n = number of years for which compounding is done.

If, any variable i.e. PV, r, n varies, then FV also varies. It is very tedious to calculate the value of  $(1 + r)^n$  so different combinations are published in the form of tables. These may be referred for computation, otherwise one should use the knowledge of logarithms.

#### ii) Future value of an annuity :



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An annuity is a series of periodic cash flows, payments or receipts, of equal amount. The premium payments of a life insurance policy, for instance are an annuity. In general terms the future value of an annuity is given as :

$$FV = A \left[ \frac{(1 + r)^n - 1}{r} \right]$$

Where,

FV= Future value of an annuity which has duration of n years.

r = Interest rate per period

n = Duration of the annuity

Thus, future value of an annuity is dependent on 3 variables, they being, the annual amount, rate of interest and the time period, if any of these variable changes it will change the future value of the annuity. A published table is available for various combination of the rate of interest 'r' and the time period 'n'.

### 2) Techniques of discounting :

#### i) Present value of a single cash flow :

The present value of a single cash flow is given as :

$$PV = FV \left( \frac{1}{(1+r)^n} \right)$$

Where,

FV = Future value n years

r = rate of interest per annum

n = number of years for which discounting is done.

#### ii) Present value of an annuity :

Sometimes instead of a single cash flow, cash flows of same amount is received for a number of years. The present value of an annuity may be expressed as below :

$$PV = FV \left( \frac{(1+r)^n - 1}{r} \right)$$

Where,



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FV = Future value n years

r = rate of interest per annum

n = number of years for which discounting is done.

Risk and return is a complex topic. There are many types of risk, and many ways to evaluate and measure risk. In the theory and practice of investing, a widely used definition of risk is:

“Risk is the uncertainty that an investment will earn its expected rate of return.”

Note that this definition does not distinguish between loss and gain. Typically, individual investors think of risk as the possibility that their investments could lose money. They are likely to be quite happy with an investment return that is greater than expected - a “positive surprise.”

However, since risky assets generate negative surprises as well as positive ones, defining risk as the uncertainty of the rate of return is reasonable. Greater uncertainty results in greater likelihood that the investment will generate larger gains, as well as greater likelihood that the investment will generate larger losses (in the short term) and in higher or lower accumulated value (in the long term.)

### UNIT – 2

#### Sources of Finance

#### Introduction of Decision making:

The financing decision involves two sources from where the funds can be raised:

- Using a **company’s own** money, such as share capital, retained earnings or borrowing funds from **the outside** in the form debenture, loan, bond, etc.
- The objective of financial decision is to maintain an **optimum capital structure**, i.e. a proper mix of debt and equity, to ensure the trade-off between the risk and return to the shareholders.



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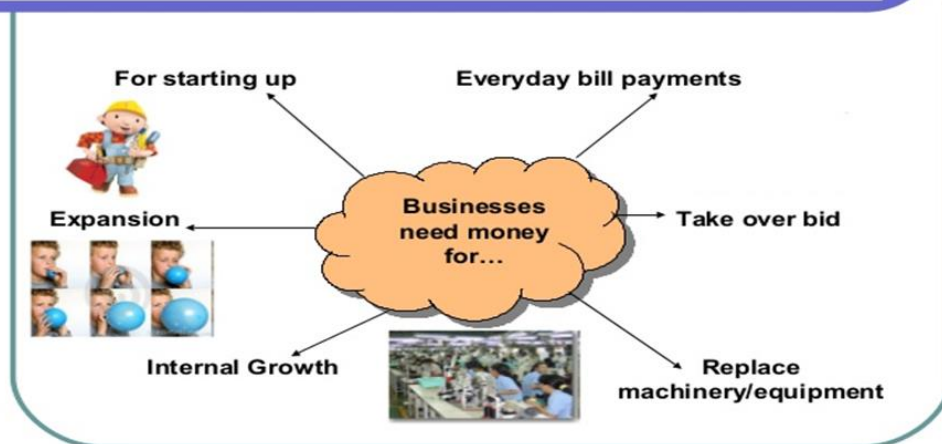
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## Needs of Finance:

### Why Do Businesses Need Finance?



#### 1. Start a Business:

Depending on the type of business, it will need to finance the purchase of assets, materials and employing people. There will also need to be money to cover the running costs. It may be some time before the business generates enough cash from sales to pay for these costs. Link to cash flow forecasting.

#### 2. Everyday bill payments:

It is called working capital need. It is required to make various payments of operating expenses like manufacturing, wages, salaries, power or electricity bill administrative expenses, marketing expenses and finance expenses of business and other repayment obligations. It is variable and short-term need.

#### 3. Takeover bid:

Finance is needed to make payment to the vendor and other expenses and commitments related to takeover of his assets and liabilities and also payment of goodwill, if any. This is a long term finance need.





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### 4. Renovation of business:

When fixed assets are to be replaced due to obsolescence or change in need of the business. This is also called need for finance for modernization or renovation of business. This is long term finance needs.

### 5. Internal Growth:

If you're looking to grow your business to take it to the next level, you may very well need funding that enables you to execute on your business plans. Whether you want to increase sales, expand your range of products or services, move into new premises, hire more staff, or expand internationally, a loan for growth finance can help. However you are planning to expand your business, growth finance that's right for your company can help you take advantage of new opportunities and make your ambitions a reality. If your business has its daily running costs covered, external funding may be the solution you need to grow. Many such loans will have fixed monthly repayments over the term of the loan, enabling you to more easily plan your business finances as you grow.

### 6. Expansion:

Finance may also be required to expand a business. For example, if a business needs to upgrade its stores or increase locations; finance may be necessary to fund any of these new or improved branches.

## NEEDS OF FINANCE:

### Long term Financial Needs:

For starting business, business needs fund for buying assets like machinery, land, plant and building. This requirement may be of 10 to 15 years.

- Starting Business
- Acquire existing Business
- Expansion of Business





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### **Medium term financial needs:**

Such requirement refer to funds for a period exceeding one year but not exceeding 5 years. It involves.....

- Renovation of Building
- Modernization of machinery
- Heavy expenditure on advertisement
- Revival of sick units

### **Short term financial needs:**

Short term financial needs are for fulfilling the working capital requirements. In this, we manage to get short term loan which will be repayable within one year.

- To run the business
- Bridge the temporary gap

### **SOURCES OF FINANCE**

- It is rightly said that finance is the life blood of Business.
- No business can be carried on without sources of finance
- There are several sources of finance and as such the finance has to be raised from the right kind of source.

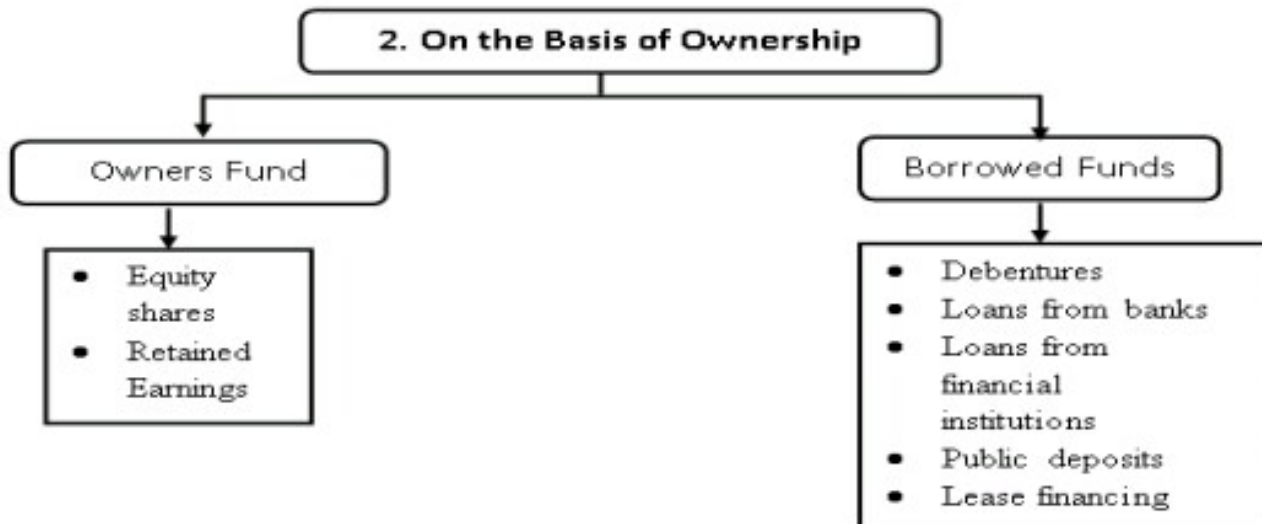
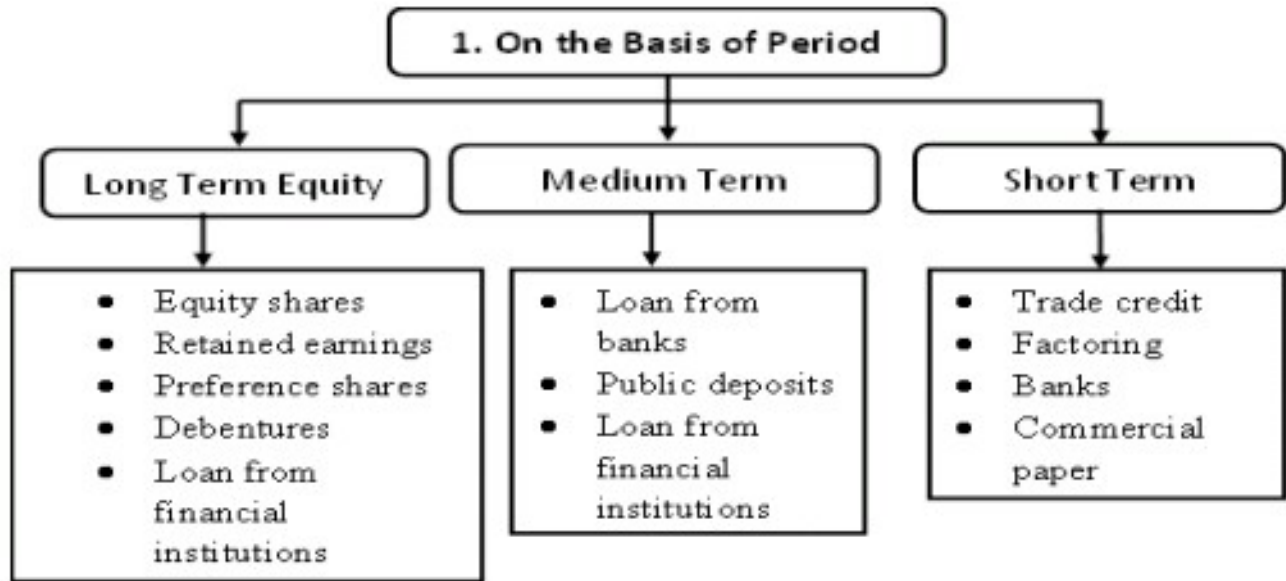


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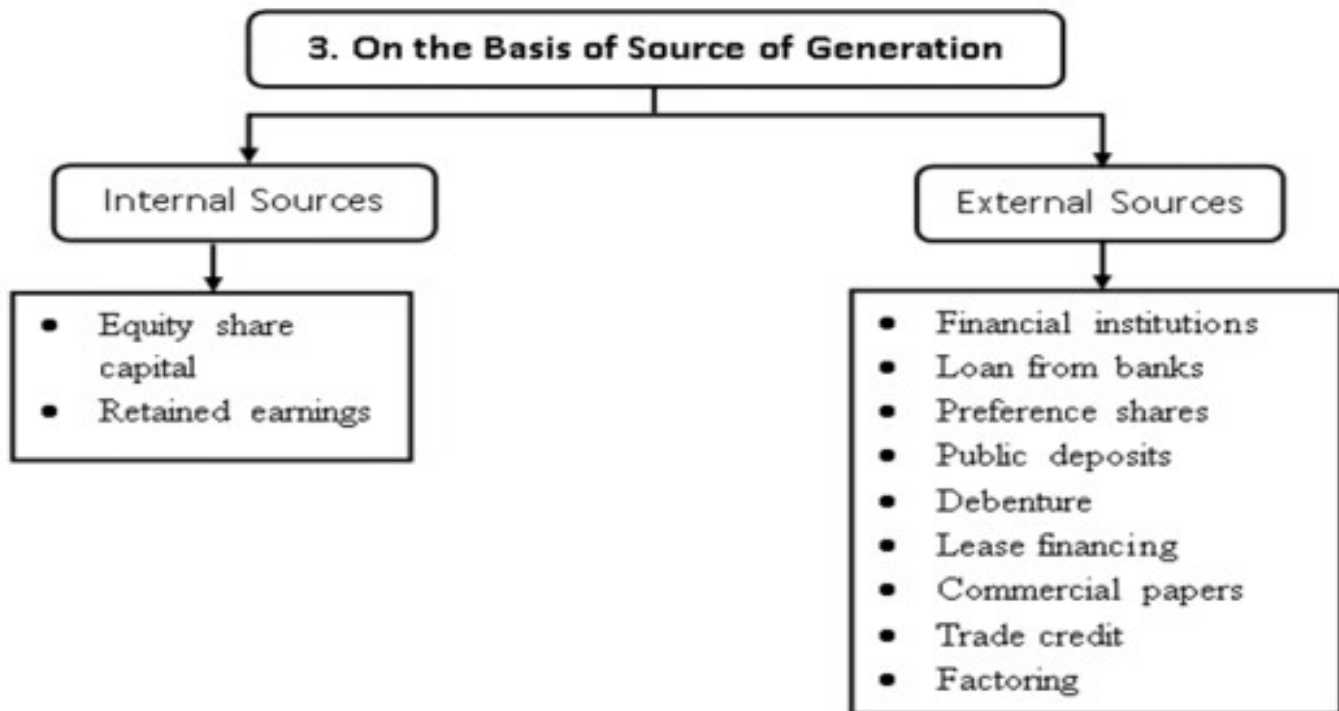


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**(A) Equity Share:** Equity shares represent the ownership of a company. They have right to vote and right to participate in the management.

### ADVANTAGES/MERITS:

- 1. Permanent Capital:** Equity share capital is important source of finance for a long term.
- 2. No charge on assets:** For raising funds by issue of equity shares a company does not need to mortgage its assets.
- 3. Higher returns:** Equity share holder get higher returns in the years of high profits.
- 4. Control:** They have right to vote and right to participate in the management.
- 5. No burden on company:** Payment of equity dividend is not compulsory.

### LIMITATIONS/DEMERITS:

- 1. Risk:** Equity shareholder bear higher risk because payment of equity dividend is not compulsory.



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- 2. Higher Cost:** Cost of equity shares is greater than the cost of preference share.
- 3. Delays:** Issue of Equity shares is time consuming.
- 4. Issue depends on Share Market Conditions:** Equity Shareholders are the primary risk bearer therefore the demand of equity shares is more in the boom time.

### (B) Preference Share

Preference shares are considered safer in investment. (As compare to equity shares) They receive dividend at a fixed rate. Preference shareholder are like creditors. They have no voting right.

#### Types of preference shares:

1. Cumulative preference shares.
2. Noncumulative preference shares.
3. Participating preference shares.
4. Non-participating preference shares.
5. Convertible preference shares.
6. Non-Convertible preference shares.

#### MERITS OF PREFERENCE SHARES:

- 1. Investment is safe:** Preference shareholders investment is safe. They have preferential right to claim dividend and capital.
- 2. No Charge on assets:** The Company does not need to mortgage its assets for issue of preference shares.
- 3. Control:** It does not affect the control of equity share holders because they have no voting right.
- 4. Fixed dividend:** They get fixed dividend. So, they are useful for those investor who want fixed rate of return.

#### LIMITATIONS/DEMERITS:

- 1. Costly sources of funds:** Rate of preference dividend is greater than rate of interest on debenture, for a company it is costly source of funds than Debentures.
- 2. No tax saving:** Preference dividend is not deductible from profit for income tax. Therefore, there is no tax saving.



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**3. Not suitable for risk takers:** Preference shares are not suitable for those who are willing to take risk for higher return.

4. As dividend on these shares is to be paid only when the company earns profit, so investors may not be very attractive to these.

### Difference between Equity Shares and Preference Shares

	Base	Equity Shares	Preference Shares
1.	Dividend	After preference shares	Priority over equity share
2.	Voting Right	Dividend is paid full voting rights.	No voting right.
3.	Risk	Risk bearing securities	Less risk
4.	Rate of Return	Fluctuates with profit	Fixed Rate of Dividend
5.	Control	Control on the management.	No control on the management.

**(C) Debentures:** Debentures are the important debt sources of finance for raising long term finance. Debenture holders get fixed rate of interest on Debentures. Interest is paid after every six months or one year. They are like creditors of a company.

### Type of Debentures:

1. Secured Debentures
2. Unsecured Debentures
3. Convertible Debentures.
4. Non-Convertible Debentures
5. Redeemable Debentures.
6. Registered Debentures.

### MERITS OF DEBENTURES:

1. Investment is Safe: Debentures are preferred by those investor who do not want to take risk and interested in fixed income.
2. Control: Debenture holder do not have voting right. No control over the managment.
3. Less Costly: Debentures are less costly as compared to cost of preference shares.



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4. Tax Saving: Interest on Debentures is a tax deductible expense. Therefore, there is a tax saving.

### LIMITATION OF DEBENTURES:

1. **Fixed Obligation:** There is a greater risk when there is no earning because interest on debentures has to be paid if the company suffers losses.
2. **Charge on assets:** The company has to mortgage its assets to issue secured Debentures.
3. **Reduction in Credibility:** With the new issue of debentures, the company's capability to further borrow funds reduces.

### Difference between Shares and Debentures

	Base	Shares	Debentures
1.	Nature	Shares are the capital	Debentures are a loan
2.	Return	Dividend	Interest
3.	Voting Right	Full voting right	No voting right
4.	Holder	Owner is called shareholder.	Creditor
5.	Types	There are two types of shares	More than two types
6.	Security	Not secured by any charge	Secured and generally carry a charge on the assets of the company

### (D) Retained Earnings:

A portion of company's net profit after tax and dividend, which is not distributed but are retained for reinvestment purpose, is called retained earnings. This is also called sources of self-financing.

### MERITS



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- 1. No costs:** No costs in the form of interest, dividend, advertisement and prospects, to be incurred by the company to get it.
- 2. No charges on assets:** The Company does not have to mortgage its assets.
- 3. Growth and expansion:** Growth and expansion of business is possible by reinvesting the retained profits.

### DEMERITS

- 1. Uncertain Source:** It is uncertain source of fund because it is available only when profits are high.
- 2. Dissatisfaction among shareholder:** Retained profits cause dissatisfaction among the shareholder because they get low dividend.

### (E) PUBLIC DEPOSITS:

The deposits that are raised by company direct from the public are known as public deposits. The rate of interest offered on public deposits are higher than the rate of interest on bank deposits. This is regulated by the R.B.I. and cannot exceed 25% of share capital and reserves.

### MERITS:

- 1. No charge on assets:** The Company does not have to mortgage its assets.
- 2. Tax Saving:** Interest paid on public deposits is tax deductible, hence there is tax saving.
- 3. Simple procedure:** The procedure for obtaining public deposits is simpler than share and Debenture.
- 4. Control:** They do not have voting right therefore the control of the company is not diluted.

### LIMITATIONS:

- 1. For Short Term Finance:** The maturity period is short. The company cannot depend on them for long term.
- 2. Limited fund:** The quantum of public deposit is limited because of legal restrictions 25% of share capital and free reserves.
- 3. Not Suitable for New Company:** New Company generally find difficulty to raise funds through public deposits.

### (F) COMMERCIAL BANKS:

Commercial Banks give loan and advances to business in the form of cash credit, overdraft loans and discounting of Bill. Rate of interest on loan is fixed.





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### MERITS

- 1. Timely financial assistance:** Commercial Bank provide timely financial assistance to business.
- 2. Secrecy:** Secrecy is maintained about loan taken from a Commercial Banks.
- 3. Easier source of funds:** This is the easier source of funds as there in no need to issue prospectus for raising funds.

### LIMITATIONS/DEMERITS

- 1. Short or Medium term finance:** Funds are not available for a long time.
- 2. Charge on assets:** Required source security of assets before a loan is sanctioned.

### (G) FINANCIAL INSTITUTION:

The state and central government have established many financial institutions to provide finance to companies. They are called development Bank. These are IFCI, ICICI, IDBI, LIC and UTI. etc.

### MERITS:

- 1. Long term Finance:** Financial Institution provide long term finance which is not provided by Commercial Bank.
- 2. Managerial Advice:** They provide financial, managerial and technical advice to business firm.
- 3. Easy installments:** Loan can be made in easy installments. It does not prove to be much of a burden on business.
- 4. Easy availability:** The funds are made available even during periods of depression.

### LIMITATIONS/ DEMERITS:

- 1. More time Consuming:** The procedure for granting loan is time consuming due to rigid criteria and many formalities.
- 2. Restrictions:** Financial Institution place restrictions on the company's board of Directors.

### INTERNATIONAL SOURCE OF BUSINESS FINANCE:

- 1. Commercial Bank:**



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Commercial Bank provide foreign currency loan for business all-over the world. Standard chartered Bank is an important organization for foreign currency loan to the Indian industry.

### 2. International Agencies and Development Bank:

A number of international agencies and development Bank e.g. IFC, ADB, provide long term loan.

### 3. International Capital Market:

#### I. GDR:

When the local currency shares of a company are delivered to the depository bank, which issues depository receipt against shares, these receipt denominated in US dollar are caller GDRs.

#### Feature of GDR:

1. GDR can be listed and traded on a stock exchange of any foreign country other than America.
2. It is negotiable instrument.
3. A holder of GDR can convert it into the shares.
4. Holder of GDR gets dividends.
5. Holder of GDR does not have voting rights.
6. Many Indian companies such as Reliance, Wipro and ICICI have issue GDR.

**II. ADR:** The depository receipt issued by a company in USA are known as ADRs (American Depository Receipts)

#### Feature of ADR:

1. It can be issued only to American Citizens.
2. It can be listed and traded is American stock exchange.
3. Indian companies such as Infosys, Reliance issued ADR

### Difference between ADR and GDR

	Basis	ADR	GDR
1.	Listing	Only in American Stock Exchange	Anywhere in the world less liquid
2.	Liquidity	More liquid	Less Liquid
3.	Share holder	Only American Citizens	All over the world citizens.



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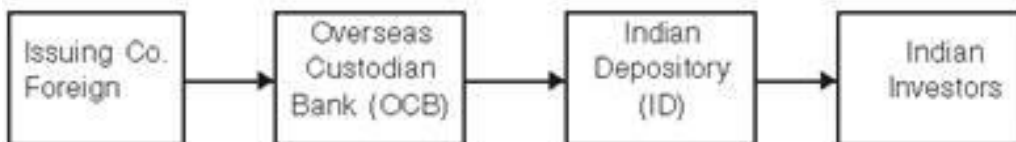
### III. Foreign Currency Convertible Bonds (FCCBs):

The FCCBs are issued in a foreign currency and carry a fixed interest rate. These are listed and traded in foreign stock exchange and similar to the debenture.

### Indian Depository Receipts (IDRS)

IDRs are like GDR or ADR except that the issuer is a foreign company raising funds from Indian Market. IDRS are rupee dominated. They can be listed on any Indian stock Exchange.

### Issue Procedure of IDRS



1. Firstly, a Foreign Co. hands over the shares to OCB (it requires approval from Finance Ministry to act as a custodian)
2. The OCB request ID to issue shares in the form of IDR.
3. The ID converts the issue which are in foreign currency into IDR and into indian rupee.
4. Lastly the ID issues them to intending investors.

### Features of IDRs

1. IDRs are issued by any foreign company
2. The IDRs can be listed on any Indian stock exchange.
3. A single IDR can represent more than one share, such as one IDR = 10shares.
4. The holders of IDR have no right to vote in the company.
5. The IDRS are in rupee denomination.

### Advantages of IDR

1. It provides an additional investment opportunity to Indian Investors for overseas investment.
2. It satisfies the capital need of foreign companies.
3. It provides listing facility to foreign companies to list on Indian Equity Market.
4. It reduces the risk of Indian Investors who want to take their money abroad.

### Inter-Corporate Deposits (ICD)

Inter-Corporate Deposits are unsecured short term deposits made by one company with another



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company. These deposits are essentially brokered deposited, which led the involvement of brokers. The rate of interest on their deposits is higher than that of banks and other markets. The biggest advantage of ICDS is that the transaction is free from legal hassles.

### Type of ICDS

- 1. Three Months Deposits** – These deposits are most popular type of ICDS. These deposits are generally considered by borrowers to solve problems of short term capital adequacy. The annual rate of interest for these deposits is around 12%.
- 2. Six months Deposits** – It is usually made first class borrowers. The annual rate of interest for these deposits is around 15%
- 3. Call deposits** – This deposit can be withdrawn by the lender on a day's notice. The annual rate of interest on call deposits is around 10%

### Features of ICDS

1. These transactions takes place between two companies.
2. There are short term deposits.
3. These are unsecured deposits.
4. These transactions are generally completed through brokers.
5. These deposits have no organized market.
6. These deposits have no legal formalities.
7. These are risky deposits from the point of view of lenders.

## UNIT – 3(A) Capitalization

### Meaning:

The objective of every business is to maximize the value of the business. In this respect the finance manager, as well as individual investors, want to know the value created by the business. The value of business relates to the capitalization of the business.

The need for capitalization arises in all the phases of a firm's business cycle. Virtually capitalization is one of the most important areas of financial management. In this article we will discuss various aspects relating to capitalization.

### Concept of Capitalization:



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Capitalization refers to the valuation of the total business. It is the sum total of owned capital and borrowed capital. Thus it is nothing but the valuation of long-term funds invested in the business. It refers to the way in which its long-term obligations are distributed between different classes of both owners and creditors. In a broader sense it means the total fund invested in the business and includes owner's funds, borrowed funds, long term loans, any other surplus earning, etc. Symbolically:

Capitalization = Share Capital + Debenture + Long term borrowing + Reserve + Surplus earnings.

Different authors have defined capitalization in different ways but the theme of those definitions remains almost same. Some of the important definitions are presented below:

According to Guthmami and Dougall, 'capitalization is the sum of the par value of the outstanding stocks and the bonds'.

In the words of Walker and Baughen, 'capitalization refers only to long-term debt and capital stock, and short-term creditors do not constitute suppliers of capital, is erroneous. In reality, total capital is furnished by short-term creditors and long-term creditors'.

Bonneville and Deway define capitalization as 'the balance sheet values of stocks and bonds outstanding'.

Hence capitalization is the value of securities and may be defined as the par value of various obligations of a firm distributed over various classes of stocks, bonds, debenture and creditors.

### **Meaning of Over-Capitalisation**

Overcapitalization occurs when a company has issued more debt and equity than its assets are worth. The market value of the company is less than the total capitalized value of the company.

An overcapitalized company might be paying more in interest and dividend payments than it has the ability to sustain long-term. The heavy debt burden and associated interest payments might be a strain on profits and reduce the amount of retained funds the company has to invest in research and development or other projects. To escape the situation, the company may need to reduce its debt load or buy back shares to reduce the company's dividend payments.

Restructuring the company's capital is a solution to this problem.



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The phrase ‘over-capitalisation’ has been misunderstood with abundance of capital. In actual practice, overcapitalized concerns have been found short of funds. Truly speaking, over capitalisation is a relative term used to denote that the firm in question is not earning reasonable income on its funds.

According to Bonneville, Dewey and Kelly, “When a business is unable to earn a fair rate of return on its outstanding securities, it is over-capitalized.”

Likewise, Gerstenberg opines that “a corporation is over-capitalized when its earnings are not large enough to yield a fair return on the amount of stocks and bonds that have been issued.” Thus, over-capitalisation refers to that state of affairs where earnings of the corporation do not justify the amount of capital invested in the business. In other words, an over-capitalized company earns less than what it should have earned at fair rate of return on its total capital.

To ascertain whether a company is earning reasonable rate of return or not, a comparison of the company’s rate of earnings should be made with earning rate of the like concerns. If the company’s rate of return is less than the average rate of return, it is indicative of the fact that the company is not able to earn fair rate of return on its capital.

It may not be out of place to mention that a company is said to be over-capitalized only when it has not been able to earn fair income over a long period of time. However, if earning position of a company is adversely affected temporarily, owing to occurrence of abnormal events like strikes, lockouts’ and fire accident it would be misnomer to consider such company in the plight of over-capitalisation. As a matter of fact, over -capitalisation is the consequence of prolonged irregularities.

In this regard it would also be noteworthy that a company having earned relatively low rate of return on its capital incessantly for a long span of time, real value of its assets would always be less than their book value.

While investing money in existing ventures investors are interested to know whether company in question is over-capitalized or not. Similar question arises in the event of amalgamation, merger or reorganization of companies.

How to test over-capitalized situation is difficult but a vital question that needs serious attention. Authorities differ on this issue. According to some scholars, when par value of shares





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3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

of company is higher than the market value, the company would be in state of over-capitalisation. As against this, others are of the view that to test the state of over-capitalisation comparison between book value and real value of shares should be made. Where book value of shares is higher than the real value, company, according to them, would be over-capitalized. To understand the concept of over-capitalisation, it would be necessary to have clear view of different values of shares. Par value of shares refers to face value of shares which is stated in memorandum of association

of the company. In this case, shares are neither issued on premium nor at discount. Par value is static in character that remains unaffected by business oscillations.

Market value of shares is the price at which shares of a company are quoted in stock exchange. Generally, market value of shares hinges, in the main, upon internal factors like present and prospective earnings position of the enterprise and its reserves and dividend policy, and external factors such as general price level changes, purchasing power and government economic and industrial policy.

International events also influence market price of shares. In view of these factors, market value of shares oscillates violently. Market value of shares of a corporation can at best be worked out by averaging out the market price of shares of the company ruling in the market over different dates. Book value of shares represents the value which is obtained by dividing the sum of capital stock and surplus accounts of the company by the number of shares outstanding.

Real value of shares is found out by dividing the capitalized value of the company's assets by outstanding number of shares. Real value of shares is too difficult to work out. By multiplying the average earnings of the company by capitalisation rate (average rate of return in the like business) company's capitalized value (or real value) of assets can be found out which when divided by the number of shares gives real value per share.

### **Causes of Over-Capitalization**

There are various factors responsible for over-capitalized state of a company; important among them being as under:

#### **(1) Promotion of a Company with Inflated Assets:**

A company right from its incorporation falls prey to overcapitalization if it has been established with assets acquired at higher prices which do not bear any relation to their earning capacity. Such a situation arises particularly when corporate form of organisation is adopted by converting a partnership firm or when private limited company is converted into public limited





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Raiya Road, Rajkot – 360001  
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firm because in that process assets may be transferred at price higher than their real value with the result that the book value of the corporation will be higher than its real value.

### **(2) Company Promoted with High Promotion Expenses:**

Over-capitalisation may sometimes result because high expenses were incurred in promoting an enterprise and promoters were fabulously paid high price for their promotional services, particularly when the earnings of the company do not subsequently justify the capital employed.

### **(3) Over-estimating Earnings at the Time of Promotion:**

A mistake in initial estimate of earnings may subsequently land a corporation into over capitalisation since capitalisation based on such an estimate is not justified by income which the firm actually earns. For example, a company's initial earning was estimated at Rs. 10,000 and industry's average rate of return was fixed at 12 percent.

Accordingly, company's capitalisation was decided at Rs. 83,333 ( $10,000 \times 25/3$ ).

Subsequently, it was found that company actually earned Rs. 8,000. Evidently in such a case company's capitalisation should have been fixed at Rs. 66,000. Thus, the company will be said to be overcapitalized by Rs. 16,667.

### **(4) Applying High Capitalisation Rate to Capitalize Earnings:**

Despite correct estimate of earnings a company may plunge in state of over-capitalisation if higher capitalisation rate was applied to determine its total capitalisation. For example, a company's earning was estimated at Rs. 10,000 and the industry average rate of return was fixed at 8 percent. Hence capitalisation rate applied was 12.5 percent. By applying this rate the company's capitalisation was worked out at Rs. 1,25,000. Subsequently, it was found that industry average rate of return was 10 percent and hence company's fair amount of capitalisation would be Rs. 1,00,000. Obviously, there is over-capitalisation in the company to the extent of Rs. 25,000.

### **(5) Company Formed or Expanded During Inflationary Period:**

Generally, companies started in the days of inflationary conditions turn into over-capitalized concerns afterward when the inflationary conditions subside because assets were acquired at inflated prices which do not bear any relation with their earning capacity. Alongside this, in anticipation of high earnings during boom period there is strong tendency to fix the capitalization at high figure. With slackening of boom conditions followed by declining trends in earning level, companies gradually turn into over-capitalized ones. Even the existing ventures expand the scale of their business to exploit the earning opportunities which will necessitate the



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raising of further capital. These firms find themselves overcapitalized after the boom period is over.

### **(6) Shortage of Capital:**

Sometimes, over-capitalisation may be the result of shortage of capital. Because of underestimation of financial requirements a firm may be capitalized at low level. This may cause serious problem to the firm subsequently when it experiences shortage of funds to meet emergent requirements compelling the firm to procure necessary funds at unreasonably high rate of interest. Consequently, lion share of firm's income may be swallowed by the lenders who come to the firm's rescue in eventuality, leaving little income available for the shareholders. This will naturally bring down the real value of the firm.

### **(7) Defective Depreciation Policy:**

Many companies become over-capitalized because they did not make adequate provision for depreciation, replacement or obsolescence of assets. Inadequate depreciation causes inefficiency in the company which, in turn, results in its reduced earning capacity.

### **(8) Liberal Dividend Policy:**

Liberal dividend policy may also contribute to over-capitalization of a company. Companies following too liberal dividend policy continuously for long period of time shall be definitely deprived of the benefits of retained earnings. Thus, in the first instance such companies fail to build up sufficient funds to replace old and worn-out assets and consequently, their operating efficiency suffers.

Secondly, these companies may, in times of necessity, be compelled to take recourse to costlier borrowing which, in turn adversely affects their earning position. The combined effects of these may land these companies in state of over-capitalisation.

### **(9) Fiscal Policy:**

Taxation policy of the Government may also be responsible for company's over-capitalisation. Due to negative taxation policy firms tax liability increases and is left with small residual income for dividend distribution and retention purposes. Further, such policy also restricts the benefits to tax deduct-ability on account of depreciation provision. Consequently, operating efficiency of companies suffers drastically and state of over-capitalisation develops in companies.

## **Consequences of Over-Capitalisation**



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Over-capitalisation is a state that affects not only the company and its owners but also the society as a whole.

### 1. Effects on the Company:

The effects of over-capitalisation on the company itself are disastrous in many ways:

- (i) Loss of goodwill. In an over-capitalised company, there is a reduced earning capacity resulting in the fall of market price of its shares and thereby shaking up the investor's confidence. A company whose shares sell below the face value may find it difficult to improve its goodwill in the market.
- (ii) Poor creditworthiness. Reduced earnings of an over-capitalised concern affect its creditworthiness and as a result, it becomes difficult for it to get loans or credit at cheaper rates of interest.
- (iii) Difficulties in obtaining capital. For a company faced with a situation of over-capitalisation, it is very difficult to obtain further capital for its growth and expansion programmes. It is so because the investors have already lost confidence in the company.
- (iv) Decline in efficiency of the company. To cover for one loss, other losses are incurred by the company and in the process overall efficiency of the company declines. Such a company usually does not make adequate provisions for depreciation, repairs and renewals, etc., leading to further decline in its efficiency.
- (v) Loss of market. Over-Capitalised companies fail to produce goods at competitive costs and, hence, often lose their market to competitors.
- (vi) Inflated profits. In order to regain the confidence of its investors, over-capitalised companies generally resort to manipulation of accounts and over-statement of their profits. These inflated profits lead to payments of dividends out of capital.
- (vii) Liquidation of company. An over-capitalised company goes into liquidation unless drastic steps are taken to re-organise the whole capital structure, and re-organisation would itself lead to a lot of problems.

### 2. Effects on Shareholders:

As, shareholders are the real owners of a company, they suffer most on account of overcapitalisation.

Some of the major effects of over-capitalisation on shareholders are:



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- (i) Reduced dividends. An over-capitalised company will not be able to pay a fair rate of dividend to its shareholders because it is earning a low rate of return (earnings) on its capital. More so, the payment of dividend becomes uncertain and irregular.
- (ii) Fall in the value of shares. Low rate of earnings and reduced dividends cause fall in the market value of shares of the over-capitalised company. Thus, shareholders have to suffer a loss in capital due to depreciation of their investments.
- (iii) Unacceptable as collateral security. The shares of an over-capitalised company have small value as collateral security. Banks and other financial institutions are reluctant to lend money against such securities. Hence, it is very difficult for the shareholders to borrow money against the security of their shares.
- (iv) Loss on speculation, the prices of the shares of an over-capitalised company remain unstable because of speculative dealings in such shares. This malpractice further adds to the losses of the shareholders.
- (v) Loss on re-organisation. An over-capitalised company has to often resort to reorganization and reduction of its capital in order to write off the accumulated losses. This results in the reduction of face value of shares and loss to its owners.

### 3. Effects on Society:

Over-capitalisation affects not only the company and its owners but also the society as a whole.

#### (i) Loss to Consumers:

In order to prevent declining trend of income, an over-capitalised concern resorts to increased prices and reduction in quality of its products.. Hence, consumers have to suffer by paying more for the poorer quality.

#### (ii) Loss to Workers:

An over-capitalised company tends to reduce wages and welfare facilities of the workers to reduce losses of the earnings. No consideration is given to the demands of the workers and some of them even lose their jobs because of layoffs and retrenchment and closure of such units.

#### (iii) Under or Misutilisation of Resources:

An over-capitalised concern either misutilises or under utilises its resources. Hence, the scarce resources of society are not properly utilised.

#### (iv) Gambling in Shares:

Another social evil of over-capitalisation is promotion of gambling habits by providing scope for gambling in shares of such a company.

#### (v) Recession:



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Over-capitalisation leads to increased losses, poor quality of products, retrenchment or unemployment of workers, decline in wage rates and purchasing power of labour. This tendency gradually affects the entire industry and the society, and may lead to recession of economy.

### **Evils or Disadvantages of Over-Capitalisation**

#### **(i) Poor Credit-Worthiness:**

When a company sells its share at less than their nominal value, i.e., less than at par, it suffers from poor credit-worthiness. Naturally, it becomes very difficult for the company to raise funds by further issue of shares as and when necessary

#### **(ii) Reduction in the Rate of Dividend:**

Since the capital is not utilized properly, i.e., the company cannot effectively use its capital employed the rate of return must be low and, consequently, the value of shares in the market may go down. .

#### **(iii) Loss to Shareholders:**

The shareholders, under the condition of over-capitalisation, are victimised and put in a very awkward position. In other words, they are in a fix as to whether they should sell the shares or retain it. If they want to sell, they will have to suffer heavily because of the lower price and, again, if they retain them, they will get a very poor rate of return by way of dividend.

#### **(iv) Loss to Employees and Labourers:**

The employees and labourers suffer since they cannot receive adequate salaries and wages owing to lower profit.

#### **(v) Loss to Creditors:**

Creditors may have to suffer since they may have to accept a lower rate of interest, and suffer permanent loss of capital in case of liquidation.

### **Remedies of Over-Capitalisation**

Effects of over-capitalisation are so grave that the management should take immediate measures to remedy the situation of over-capitalisation as soon as the symptoms of the over-capitalisation are observed.

Various remedial measures such as reduction in bonded debt, reduction of rate of interest paid on debentures, redemption of high dividend preferred shares, reduction of par value of shares





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and reduction of number of shares are suggested. We shall now examine efficacy of each of these measures as curative to the problem of over-capitalisation.

### **(1) Reduction in Bonded Debt:**

To cut the knot of over-capitalisation, over-capitalized concerns are suggested to reduce the amount of bonded indebtedness to prune the amount of capital in accordance with their earning position. This measure seems to be inexpedient. Redemption of debt needs additional funds which can be procured either from reinvested earnings, or from sale of additional stock. Since profit of over-capitalized concerns might be extremely low, it would be necessary for them to go to stock market for sale of their securities. They would, however, find it difficult to raise required amount of share capital because public response to their issues might not be very encouraging in view of their reduced earning position and increased financial instability. Furthermore, shares of such companies are quoted at low prices in stock markets. Consequently, they might be compelled to issue large stock to raise the money. This, instead of remedying the problem, might aggravate it.

### **(2) Reduction of Fixed Charges on Debt:**

It is also suggested that with a view to improving their earning position over-capitalized concerns should slash down the burden of fixed charges on debt. For that matter, existing bond holders will have to be made to agree to accept new bonds carrying lower interest rate in lieu of their old ones. The bondholders might agree to accept the new bonds provided these are issued to them at premium. This again fails to remedy the situation.

### **(3) Redemption of High Dividend Preferred Stock:**

To reduce the burden of fixed charges on the over-capitalized company it is suggested to reduce preferred stock bearing high dividend rate. However, this might also not prove more meaningful because large amount of funds would be needed to redeem the preferred stock, raising of which would increase the amount of capitalisation instead of reducing it.

### **(4) Reducing Par Value of Shares:**

It is often suggested that an over-capitalized concern should reduce the amount of stock outstanding by reducing par value of shares. This is nothing but reorganization of share capital which helps the concern in obscuring the real state of affairs. Supposing a company is capitalized at Rs. 10,00,000 with 5,000 ordinary shares of Rs. 200 per share and the company's average annual earning is Rs. 50,000. Thus, the company's earnings per share is Rs. 10 and return on total capital employed is Rs. 5. Now, if the company reduces the par value of shares



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by 50% and transfers the same to surplus account, it would result in increase in return on capital by 100%.

Thus, through simple process of accounting, condition of over-capitalisation can be converted into that of undercapitalization. But it would be difficult to convince the shareholders in this respect. They may believe it to be management trick to dupe them by giving them lower par value stock in exchange for higher value stock though in fact real value of shares is in no way affected.

### **(5) Reducing Number of Shares:**

By reducing number of outstanding shares, efforts are made to correct the outward symptoms of overcapitalization. For example, a company is capitalized with 10,000 shares of Rs. 10/- each. If the management decides to issue one new share in exchange of four old shares and shareholders agree to accept the decision, number of shares is reduced to 2,500.

As a result of this, earning per share tends to go up by the same proportion. This, in turn, may help the company to improve its credit position in the market and its share values consequently may soar.

In sum, reorganization of share capital either by reducing par value of shares or by reducing number of outstanding shares is the only panacea to the problem of over-capitalisation provided the management succeeds to convince the shareholders about the utility of this step.

### **Meaning of Under-Capitalisation**

Undercapitalization occurs when a company does not have sufficient capital to conduct normal business operations and pay creditors. This can occur when the company is not generating enough cash flow or is unable to access forms of financing such as debt or equity.

Undercapitalized companies also tend to choose high-cost sources of capital, such as short-term credit, over lower-cost forms such as equity or long-term debt. Investors want to proceed with caution if a company is undercapitalized because the chance of bankruptcy increases when a company loses the ability to service its debts.

The phrase 'Under-capitalisation' should never be misconstrued with inadequacy of capital. Truly speaking, this term is used to denote the state of affairs just converse of over-





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capitalisation. When a company succeeds in earning abnormally large income consistently for a pretty long time, symptoms of under-capitalisation gradually develop in the company; the most important one being that market value of shares of the company exceeds their book value. Undercapitalisation is an index of effective and proper utilisation of funds employed in the enterprise.

It should be noted in this regard that if a company under exceptionally good conditions makes substantially large earnings in a year or so, it should not be considered that the company is under-capitalized. Over-capitalised concerns have always earning superiority over average concerns engaged in the same line of activity.

Thus, under-capitalisation is indicative of sound financial health and good management of the company. Bonneville and Dewey rightly observed that “Under-capitalisation is not an economic problem but a problem in adjusting the capital structure”.

### **Causes of Under-Capitalisation**

Potent causes of under-capitalisation in a company are as follows:

#### **(1) Under-Estimation of Initial Earnings**

If earnings of new venture were under-estimated and the enterprise was capitalized accordingly, it may find itself in condition of under-capitalisation afterwards when it's actual earning was much more than what was anticipated.

#### **(2) Using Low Capitalisation Rate:**

If low capitalisation rate was employed to determine capitalisation of a company, it might plunge in state of under-capitalisation subsequently when it would be found that actual capitalization rate was much higher than the employed one.

#### **(3) Deflationary Condition:**

Companies set up in recessionary condition generally become under-capitalized after recession is over. There are two factors contributing to this tendency. In the first instance, during recession assets are purchased at exceptionally low prices which bear no relation with their income producing capacity. As period of recession abates, earning position of the companies tends to improve.

This would result in increase in real value of assets while book value of assets remains as before and the consequence would be under-capitalisation. Secondly, companies set up in period of recession are capitalized at low figure anticipating low level of business income. But as the



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period of recession is over, company's earning capacity improves and the result is undercapitalization.

#### **(4) Conservative Dividend Policy:**

Company following conservative dividend policy builds up substantially large funds available for replacement and renovation of obsolete assets and for financing developmental and expansion purposes. This thus goes a long way in improving earning position of the company.

#### **(5) Maintaining High Standards of Efficiency:**

By employing new techniques of production and rationalization of production activities, operating efficiency of a company can be improved.

### **Consequences of Under-Capitalisation**

#### **On Company:**

Although under-capitalisation does not threaten financial stability and solvency of the enterprise, management should not be complacent towards this situation because the company may suffer in the following ways:

(i) Under-capitalisation intensifies the degree of competition which may have telling effect on profit margin of under-capitalized concerns. High earning rate of under-capitalized companies may entice entrepreneurs to set up enterprises in the same line of business who may put up tough fight with the under-capitalized concerns.

(ii) Tax liability of under-capitalized concerns increases in correspondence with increase in volume of profits. Also belts of state control and intervention over these enterprises are tightened.

(iii) Marketability of shares of under-capitalized concerns tends to be narrow because of exceptionally high market price of these shares. Share prices register violent fluctuations and speculators take undue advantage of this situation.

(iv) In view of continued rise in profitability rate workers may demand increase in their wage rates and if their demand is not fulfilled it may cause discontentment among them. Labour management relation is disturbed which may adversely affect production efficiency of the corporation.

(v) Consumers may feel being fleeced by the management of under-capitalized company who are, it is alleged, thriving at their cost. They may raise hue and cry for reducing price of the product and demand vociferously for the state to intervene and control their operations.



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### On Share-Holders:

Under-capitalisation is advantageous to shareholders in as much as they get high dividend income regularly. Because of soaring rise in share price of under-capitalized concerns, shareholders' investment in these companies appreciates phenomenally which they may encash at any time. In another way also, under-capitalisation benefits the shareholders. They can, in periods of necessity, get loans on soft-terms against the security of their shares because of high credit standing of the under-capitalized concerns in the market.

- (i) The profitability of the company may be very high. As a result, the rate of earnings per share will go up.
- (ii) The value of its equity share in the market will go up.
- (iii) The financial reputation of the company will increase in the market.
- (iv) The shareholders can expect higher dividends regularly.

### On Society:

- (i) Under-capitalisation may lead to higher profits and higher prices of shares on the stock exchange. This may encourage unhealthy speculation in its shares.
- (ii) Because of higher profits, the consumers feel exploited. They link higher profits with higher prices of the products.
- (iii) The management of the company may build up secret reserves and pay lower taxes to the Government.

### Disadvantages of Undercapitalization

Undercapitalized companies suffer from the following disadvantages.

- (i) Conflict between labour and management. Higher rate of earning encourages workers to demand higher increase in the wages. Management does not meet their demand fully, so the conflict between labour and management starts.
- (ii) Consumers' feeling of exploitation. Declaration of dividend at higher rates creates a feeling among Consumers that they are being exploited, because the company instead of decreasing price of the commodity is increasing the dividend rates.
- (iii) Manipulation in the value of shares. The management indulges in the manipulation of the value of shares and exploits shareholders.
- (iv) Higher rates of taxation. Earnings at higher rate attract the government for levying taxes at higher rates.



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### Remedies for Under-Capitalisation

To correct condition of under-capitalisation it is inevitable on the part of the company to reorganize its capital structure in such a way that number of shares increases and earning per share is reduced.

For this purpose the following two measures might be helpful:

#### (1) Capitalisation of Surplus of the Company:

If a company has adequate surplus in hand the whole or a part of it can be capitalized by issue of bonus shares. This will, in no way, affect the quantum of capitalisation. Of course, make-up of capitalisation will undergo marked change. Thus, with issue of bonus shares, share capital will increase and so also the number of shares but surplus of the company will lie reduced by the amount of bonus shares.

In consequence, earnings per share automatically are reduced. Take for example, a company has total capitalisation of Rs. 2,00,000 comprising share capital of Rs. 1,50,000 (divide in 3,000 shares of Rs. 50 per share) and surplus of Rs. 50,000. The company's present earning is Rs. 60,000.

Thus earning per share in this case comes to Rs. 20 per share. Management may save this company against the effects of under-capitalisation by issuing bonus shares. If, for example, it is decided that the company will issue 5,000 bonus shares of Rs. 10 each, share capital in the company will increase from Rs. 1,50,000 to Rs. 2,00,000 and number of shares from 3,000 to 8,000 though of course amount of total capitalisation remains unchanged.

As a result of this, earning per share which was earlier Rs. 20 would, after capitalisation, decline to Rs. 7.50.

However, owner's income is no longer affected. They would continue to receive the same amount of income even after recapitalization. This would keep the management free from workers' threats; consumers do not feel being exploited by capitalists.

#### (2) Splitting Stock:

Another effective way of reorganizing capitalisation of a company to reduce the effects of undercapitalisation is to split up the stock into a large number of shares and reduce the value of each share in accordance with the rate of split up.



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The effect of this split is that the earnings would be spread over a greater number of shares, Supposing a company is capitalized with Rs. 1,00,000 divided into 1000, its earnings per share would come to Rs. 10. Management may reduce earnings per share if it so likes by taking recourse to stock split. If, for example, the management decides to reduce par value of shares by 50 percent and increase the number of shares in the same proportion, number of shares in the company would after splitting double to reach 20,000 shares and earnings per share would be halved to Rs. 5.

The shareholders will have no objection to this procedure because they are not going to lose anything. Thus, by this simple device the management can neutralize the effects of undercapitalisation and save the company from any eventuality. It is evident from the foregoing discussions that both the strategy under-capitalisation and overcapitalisation are undesirable and should be discouraged as far as possible. Over-capitalisation means a great strain on the financial structure of a company, an evil for shareholders and a menace to economic prosperity, and stability of society.

On the other hand, under-capitalisation encourages competition on the part of business rivals, sows seeds of dissension among labourers and creates psychic feeling of being exploited among consumers. On comparison, state of over-capitalisation relatively is more harmful. However, the management should avoid emergence of both these situations and its ideal should be of fair capitalisation.

(3) Under-capitalisation may be remedied by increasing the par value and/or number of equity shares by revising upward the value of assets. This will lead to decrease in the rate of earnings per share.

(4) Management may capitalise the earnings by issuing bonus shares to the equity shareholders. This will also reduce the rate of earnings per share without reducing the total earnings of the company.

(5) Where under-capitalisation is due to insufficiency of capital, more shares and debentures may be issued to the public.

### **Over capitalization vs under capitalization**



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1. Comparing the two, it can be concluded that over-capitalisation proves to be more dangerous to the company, shareholders, and the society as a whole. On the contrary, under-capitalisation may encourage competition but it may also stimulate dissatisfaction among the workers and the consumers.
2. Over-capitalisation involves a great-strain on the financial resources of a company whereas under-capitalisation implies high rate of earnings on its shares.
3. The remedial procedure of over-capitalisation is more difficult and expensive as compared to the remedial procedure of under-capitalisation.
4. Under-capitalisation accelerates cut-throat competition amongst companies; results in discontentment among employees and grouse amongst customers; whereas over-capitalisation adversely affects the shareholders and endangers the economic stability and Social prosperity.
5. Over-capitalisation is a common phenomena than under-capitalisation which is relatively a rare phenomena.
6. Over capitalization is a state where earnings are not sufficient to justify the fair return on the amount of share capital which has been issued by the company whereas under capitalization is a state where the capital which is owned by the business is much less than the borrowed capital.
7. Over capitalization happens when the actual profits of a company are not enough or sufficient to pay interest to the creditors whereas under capitalization happens due to over-trading and when the company earn high profits as compared to other industry.
8. Over capitalization shows the rate of return as declining entity whereas undercapitalization shows the rate of return as increasing entity.





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## Human Resource Management

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## UNIT – 1

### INTRODUCTION TO HUMAN RESOURCE MANAGEMENT

#### Concept & Introduction of HRM:

- In the era of globalization, mergers and acquisitions, several changes are taking place and there is a global focus on quality, excellence, flexibility and transformation.
- As a result, management of human resources has become an integral part of organization activity and has been termed as Human Resource Management.
- The concept of HRM actually has evolved from the term personnel management which is concerned with staffing, developing, rewarding and motivating employees.
- Human Resource Management (HRM) is an operation in companies designed to maximize employee performance in order to meet the employer's strategic goals and objectives.
- More precisely, HRM focuses on management of people within companies, emphasizing on policies and systems.
- In short, HRM is the process of recruiting, selecting employees, providing proper orientation and induction, imparting proper training and developing skills.
- HRM also includes employee assessment like performance appraisal, facilitating proper compensation and benefits, encouragement, maintaining proper relations with labor and with trade unions, and taking care of employee safety, welfare and health by complying with labor laws of the state or country concerned.

#### Definitions:

"HRM refers to a set of policies, designed to maximize organizational integration, employee commitment, flexibility and quality of work."

Ronald Ebert and Ricky W. Griffin define: "HRM refers to attracting, developing and maintaining an effective workforce."

Edwin Flippo: "Human resource management is the planning, organising, directing and controlling of the procurement, development, compensation, integration, maintenance and separation of human resources to the end that individual, organisational and social objectives are accomplished."

#### Difference Between Personnel Management And Human Resource Management:

Human resource management is the new version of personnel management. There is no any watertight difference between human resource management and personnel management. However, there are some differences in the following matters.



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1. Personnel management is a traditional approach of managing people in the organization. Human resource management is a modern approach of managing people and their strengths in the organization.
2. Personnel management focuses on personnel administration, employee welfare and labor relation. Human resource management focuses on acquisition, development, motivation and maintenance of human resources in the organization.
3. Personnel management assumes people as an input for achieving desired output. Human resource management assumes people as an important and valuable resource for achieving desired output.
4. Under personnel management, personnel function is undertaken for employee's satisfaction. Under human resource management, administrative function is undertaken for goal achievement.
5. Under personnel management, job design is done on the basis of division of labor. Under human resource management, job design function is done on the basis of group work/team work.
6. Under personnel management, employees are provided with less training and development opportunities. Under human resource management, employees are provided with more training and development opportunities.
7. In personnel management, decisions are made by the top management as per the rules and regulation of the organization. In human resource management, decisions are made collectively after considering employee's participation, authority, decentralization, competitive environment etc.
8. Personnel management focuses on increased production and satisfied employees. Human resource management focuses on effectiveness, culture, productivity and employee's participation.
9. Personnel management is concerned with personnel manager. Human resource management is concerned with all level of managers from top to bottom.
10. Personnel management is a routine function. Human resource management is a strategic function.

## Difference in tabular form:



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PERSONNEL MANAGEMENT	HUMAN RESOURCE MANAGEMENT
PM is only management of people	HRM is management of employees' skills, knowledge, abilities, talents, aptitude, creative abilities
PM views man as economic person	HRM views man not only as economic person but also looks at him as a full person – taking social and psychological factors in views
Employee is treated as cost centre and hence controls cost of “Personnel” in the organization	Employees are treated as profit centre and hence they invest in HRD – and future accrue from this resource
Employee is viewed as tool or equipment which can be purchased and used	Employee is treated as a resource
Employees are utilized for organizational benefits	Employees are utilized for mutual benefit – both for organization and employees

## The function of HR managers can be classified into managerial and operative functions

### HRM Functions:

#### (I) Managerial Functions:

1. Planning
2. Organizing
3. Directing
4. Controlling

#### (II) Operative Functions:

1. Procurement
2. HR Development
3. Compensation
4. Maintenance
5. Motivation
6. Integration
7. Others

#### (I) Managerial Functions:

These are a set of functions that a manager performs to get the things done from others. These functions include the following

#### 1. Planning:



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This function deals with predetermining the future course of action. It involves the determination of objectives, programmes, policies, procedures and rules. These plans may be for short term, medium term or long term. He plans for procurement, compensation and maintenance of employees in the organization.

## **2. Organizing:**

This involves the process of dividing the work into smaller parts and allocating these tasks to people. Thus, group of people performing similar tasks can be formed. They are further grouped as departments and the organizational structure is formed. This function also determines how efficiently an organization performs its functions.

## **3. Directing:**

This function pertains to providing proper instructions to people working in the organization. It also involves supervising, leading and motivating employees to work enthusiastically for the attainment of organizational goals.

## **4. Controlling:**

This function comprises of identifying deviation gaps between expected results and actual results and then taking corrective action for the efficient accomplishment of goals. It highlights individual performance through reports, reviews and audits. It also points out the blocks/hurdles in better performance and shows the areas for improvement.

## **(II) Operative Functions**

The operative functions are those functions which are related to particular department and performed for the attainment of departmental objectives.

### **1. Procurement Function:**

- A. Human Resource Planning**
- B. Recruitment**
- C. Selection**
- D. Placement**
- E. Induction and Orientation**
- F. Internal Job Changes**

This function pertains to procuring the right person for the right job. It involves hiring people as per the need of the organization. It includes the following

### **A. Human Resource Planning**



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This function is concerned with determining the number of people required for various jobs and the different types, of qualifications, skills and qualities required in various personnel for different jobs.

## **B. Recruitment**

It is the process of linking job seekers and job providers. It involves searching for and attracting prospective employees and motivating them to apply for jobs.

## **C. Selection**

It is the process of identifying from a pool of applicants the most suitable person for a particular job based on his experience, skills, qualities and qualifications.

## **D. Placement**

It is the process of placing the selected candidate on the determined job. It is the final stage in the procurement process. To place the right candidate on the right job is the responsibility of the HR manager.

## **E. Induction and Orientation**

It is the introduction of a new employee to the organization or department and making him aware of the surroundings, policies and practices of the unit. This makes the employee comfortable and he gets acquainted with his work.

## **F. Internal Job Changes**

Promotions and transfers are the methods of internal job changes. An employee moves either horizontally or vertically within the organization.

## **2. Development Function**

- A. HRD System**
- B. Training**
- C. Managerial Development**
- D. Career Planning and Development**
- E. Organizational Development**

This is the function to train employees for enhancing their performance on present job. It also aims at developing employees' skills, abilities and aptitude for future positions and changing the organizational culture and to match individual and organizational requirements.

## **A. HRD System**



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HRD is a system in which there is development of the organization as a whole. It is about creating an environment in which every employee is able to utilize and develop his/her abilities to achieve individual and organizational goals.

## **B. Training**

It is a process by which employees learn and enhance skills and abilities for better performance of duties and responsibilities shouldered on him.

## **C. Managerial Development**

It is the process of developing managerial skills and capabilities in the human resources for effectively carrying out their present and future roles in the organization. This is done through well planned development programmes conducted for the human resources by the Human Resource manager.

## **D. Career Planning and Development**

An individual can plan for one's own career by joining educational or/and training programmes, gaining job experiences which help him utilize or enhance his skills and abilities.

## **E. Organizational Development**

It is an organization wide strategy used to bring about changes at the overall organizational level. It involves changing the environment, culture, structure to improve an organization's adaptation to new technologies, markets and dynamic challenges faced due to changing times.

## **3. Compensation Function**

It involves determining the basic pay, incentives, benefits and services offered in the form of reward for the services rendered by the human resources.

### **A. Job evaluation**

### **B. Compensation Management**

### **C. Incentives**

### **D. Benefits and Service**

### **A. Job evaluation**

It is a systematic process to determine the relative worth of a job as compared to other jobs in the organization. This helps in establishing the same value for similar jobs and identifying those jobs which need to be paid higher than others.



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## **B. Compensation Management**

It involves the process of determining a pay plan that is attractive, motivating and considered as fair by the employees. It helps in retaining employees and makes it clear about how much is to be paid to each and every employee.

## **C. Incentives**

In addition to the basic pay, an incentive is paid based on effectiveness in performance. Examples: An employee who achieves 100% targets given to him gets an incentive of Rs.10% on his basic pay whereas an employee achieving 95% gets only 7% and the one achieving 80% gets no incentive.

## **D. Benefits and Services**

Today organizations offer many benefits like Workmen's' Compensation, provident scheme fund, Pension Scheme, insurance etc. are offered to the employees working in the organization. They are with club membership, vacations, festival bonus, paid rest periods etc.

## **4. Maintenance Function:**

This function aims at providing various welfare measures to protect the health of their employees. It includes proper communication, health and safety measures, welfare, employee participation, counseling and mentoring.

### **A. Communication**

### **B. Health and Safety Measures**

### **C. Employee welfare**

### **D. Employee Participation**

### **E. Stress Management**

### **F. Counseling and Mentoring**

### **A. Communication**

Appropriate and timely communication directs an employee towards the performance of his tasks and accomplishments of targets. This provides job satisfaction to an employee working in the organization.

### **B. Health and Safety Measures**

The organization must ensure that the work environment protects its employees against unhealthy conditions, unsafe acts of other employees and any kind of physical hazards. By enforcing safety measures and health standards, the physical and psychological wellbeing of human resources is ensured.

### **C. Employee welfare**





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This includes offering facilities and amenities to employee for their physical mental and social well being. Facilities like transportation, recreation, social security measure likes, medical benefits, maternity benefits are offered to employees within or outside the organizational setup.

## **D. Employee Participation**

Giving the right to decisions to lower level employees gives them an opportunity to have an insight on the functioning of an organization and the importance of the functions performed by them for the organization.

## **E. Stress Management**

Stress is the biological and Psychological reaction to a situation. In organizations, stress converts into burnout which leads to increased absenteeism, turnover and reduced job satisfaction. Employee Development and Stress Management Programmes are conducted to promote the physical and mental well being of their employees.

## **F. Counseling and Mentoring**

These are techniques to help an employee cope up with his problems in a better way, develops understanding, self control and understanding in employees.

## **5. Motivation Function:**

It is the process of stimulating people to work enthusiastically for the organization. It can be done by providing monetary and monetary rewards to the employees.

### **A. Performance Appraisal**

### **B. Potential Appraisal**

### **C. Financial Reward System**

### **D. Non financial reward system**

#### **A. Performance Appraisal**

An employee's performance on the job is evaluated in order to assess how well he is performing on his current job. This evaluation is then communicated to an employee and suggestions are provided for improvement in performance.

#### **B. Potential Appraisal**

Potential Appraisal is a technique identifies the ability/potential of an employee for better opportunities or higher level jobs. These appraisals are carried out to help then organization in making their succession plan.

#### **C. Financial Reward System**



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In addition to wages employees are paid incentives which are paid to employees based on their performance. These are not compulsory but they act as a motivator.

## **D. Non-financial reward system**

Certain organization gives awards for good performers in order to motivate them to perform better. Promotions and transfers also act as motivators.

## **6. Integration function**

This is the function which combines individual goals and organizational goals.

- A. Grievance Handling**
- B. Discipline**
- C. Collective Bargaining**
- D. Industrial Relations**
- E. Employee Empowerment**
- F. Trade Unions**

### **A. Grievance Handling**

A grievance is dissatisfaction or a complaint of an employee. It could be regarding wages, working hours or working conditions. It is the procedure which involves listening to and settling employee grievances.

### **B. Discipline**

It is the system which motivates the employees to follow certain rules and regulations for the effective attainment of organizational goals.

### **C. Collective Bargaining**

It is the process of bargaining between management and trade unions on matters relating to wages, hours of work, rest pauses, benefits, vacations, layoffs and other such matters related with employment or terms of employment. After bargaining both the parties make an agreement which is implemented by them for establishing better relations and smooth functioning of the organization.

### **D. Industrial Relations**

The secret of high productivity and growth of an organization are peaceful and harmonious relations between the management and workers. An environment of trust, contentment and openness exists which reduces the chances of conflicts among them.



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## **E. Employee Empowerment**

When the employees are given the power to make decisions and participate in the day to day functioning of the organization, it can be called employee empowerment. By doing this an employee understands his role in the growth and development of his organization.

## **F. Trade Unions**

It is an association of employees or employers formed with the intention of its members' welfare and protecting them against any kind of exploitation.

## **7. Other Functions**

HR practices are undergoing drastic changes due to globalization, mergers and acquisitions. There are a few other functions that fall within the preview of Human resource management.

### **A. Record Keeping**

### **B. HR Audit**

### **C. HR Research**

### **D. HR Accounting**

#### **A. Record Keeping**

Records such as employee's personal data, appraisal reports, HR policies and programmes need to be documented and maintained properly as the records of the organization.

#### **B. HR Audit**

Human resource Audit is the process of evaluation of the HR policies and procedures in order to determine their effectiveness and relevance to continue them in future.

#### **C. HR Research**

It is the process of evaluating the effectiveness of the HR policies already being practiced and involves designing new ones to augment their effectiveness.

#### **D. HR Accounting**

It is the process of ascertaining the value of human resources of an organization by doing a cost benefit analysis and identifying the human assets of the organization.

## **Characteristics of HRM:**

1. **It is a Human Activity:** HRM is people oriented activity. It aims at providing employee satisfaction through proper placements, training and motivation.



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2. **It is a Sub System:** It is a sub system of a bigger system called the organization involving every employee and impacting every person in the organization. All the activities of the organization are planned and carried out by its human resources.
3. **It aims at Human Development:** It is aimed at developing human abilities and potential so that they enable the organization in achieving its goals.
4. **It considers human beings as distinct from other resources:** It focuses on human being as a distinct resource as they can work individually and in teams to utilize other resources effectively and provide a competitive edge to the organization.
5. **It is a continuous activity:** It is an ongoing or continuous activity which involves recruiting employees, training and motivating them to work, building relationships with employees, making policies, implementing them and solving employee problems.
6. **It is goal oriented:** HRM is a goal oriented activity with a vision to achieve specific goals in future. It directs and motivates people to work towards the effective achievement of the set goals.
7. **It is multidisciplinary in nature:** It involves the study of various disciplines such as psychology, sociology and semantics.
8. **It requires top management support:** Its success is based on the commitment and support from top level management. The policies and ideologies framed need sanction from top management for its implementation.
9. **It is interrelated with all other departments:** It is a network which integrates employees, customers, machines, Materials, processes and helps in building and maintaining cordial relation's amongst all.
10. **It is not mere record keeping:** HRM is more practical in nature. It believes in forming employee friendly policies and bringing unit in action and not just maintaining HR records and regulations.
11. **It is globally oriented:** It is a function which applies to all types of organizations, whether it is a school, hospital, government body or any corporate entity.

## **Significance of HRM:**



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1. **Effective utilization of human resources:** It helps in effective utilization of human resources by motivating them towards the work and organizations and retaining them in the organization.
2. **Prepares employees to adjust with changing needs of organization:**HRM helps in developing employees towards the changing needs of the organization. Thus it ensures a continuous flow of competent people for accomplishing organizational goals.
3. **Builds Employee loyalty:**HRM helps in changing attitudes of employees towards the organization and builds employee loyalty.
4. **Maintains the dignity of employee:**HRM ensures that the dignity of employees at the workplace is maintained.
5. **Creativity and innovation:**It provides an environment for developing creativity / new ideas at the work place.
6. **Good working environment:** It provides proper work environment so that the capabilities of people are effectively utilized.
7. **Employment opportunities:**It is a link between job seekers and job providers and generates employment opportunities.

## **HR Policy**

- Policy is a guideline or a statement for making decisions and performing various functions in the organization. According to Kotler, "Policies define how the company will deal with stakeholders, employees, customers, suppliers, distributors and other important groups.
- Policies narrow the range of individual discretion so that employees act consistently on important HR issues." HR policies provide guidelines on managing its people, they define philosophies on treating people and then principles are designed. The principles are guidelines on which managers have to deal with HR matters.
- They provide guidelines for a variety of employment relationships and identify organization's intentions in recruiting, selecting, developing, promoting, compensating, motivating and integrating HR.
- Although HR policies provide guidelines and restrict freedom of action but they also provide guidelines to thinking with an element of discretion while decision making.
- They help to predefine techniques to settling issues and avoid repetitive analysis of similar matters. They also enable proper delegation of authority.



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- HR policies emerge from various sources. They flow from top to bottom level. Some policies are not written but the actions of managers provide guidance to subordinates as policies.
- Certain policies are also imposed by the Government or parent organization of a business house or a trade association. Sometimes policies are made by superiors on request from the subordinates and as needed by them.
- Policies differ from the organization to organization.

## Examples of specific HR policies:

1. To provide equal employment opportunities to the people of minority sections
2. Every employee shall have necessary empowerment and shall take responsibility
3. To Institute every practical method for engineering safety into our processes and equipment
4. To provide a healthy plant, by giving adequate attention to cleanliness, temperature, ventilation, light and sanitation
5. The implementation of HR policy is a strategic issue in which we must all participate

## Sources for formulating HR policies:

1. Past experience of the organisation
2. Attitudes, philosophies of Management at employee level, trade union level, and all other levels like middle level to top level
3. Knowledge and experience of HR managers and other line managers from day to day activities
4. Prevailing HR practices in other organisations in the same region, state, country or world or in Rival companies
5. Organisational policies
6. Attitudes and philosophy of the founders of the organisation
7. Implied policy constituted by actions of higher level managers

## Objectives of HR policies:

1. To ensure that adequate, competent and trained personnel at all levels are available to the organisation
2. To provide an atmosphere where employees can perform the duties effectively and willingly and develop a sense of Unity with the organisation
3. To provide and create a sense of responsibility and adopt a humanitarian approach while dealing with human resource and also to guarantee protection of dignity and fundamental rights of employees
4. To establish conditions of mutual trust, understanding and cooperation between people who work and people who manage
5. To create conditions for optimum utilisation and development of human resources for the personal as well as organisational benefits

## Characteristics of sound HR policies:



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1. They must be clear to understand and implement and not confusing
2. They must be carefully planned and formulated foreseeing every problem that may be faced in future
3. They must be consistent with the organisational objectives and must contribute towards the achievement of organisational objectives
4. They must be matched and integrated with all the areas of the business like production, marketing and Finance
5. Any policy must be in written form so that it can be specific and can be communicated as well as referred in times of confusion
6. It must be appropriately communicated to the concerned person so that it can be implemented effectively
7. It should be stable as well as flexible when needed and should be revised from time to time

## Areas covered under HR policy

### **1. Acquisition**

These policies include reservation of positions for various classes of people, minimum educational qualifications required, selection tools, probation period in service etc.

### **2. Compensation**

These policies include the system/method used for job evaluation, basis for compensation, types of incentives and benefits offered.

### **3. Appraisal**

It includes methods of appraisal, extent of formalizing this process, using the appraisal results.

### **4. Training and Development**

These policies include decision on whether learning should be continuous or periodic, random or outsourced. It also includes deciding training methods, organization for providing training, its budget and measurement of training effectiveness.

### **5. HR Mobility**

These policies cover decisions on basis of promotion, transfer policy, demotion to be practiced or not, degree of internal recruitments, retention strategies if any, voluntary retirement schemes and retirement age.

### **6. Working Conditions**

Guidelines are prepared to predetermine timings and rest schedules, Overtime policy, number of shifts and shift duration, amount of light, ventilation and other conditions.





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## 7. Industrial Relations

Policies are made for building and maintaining industrial relations, policy for recognition given to trade unions, measures to instill industrial peace, procedure for settlement of industrial disputes and involving employees in settlements and decisions.

## HR Philosophy

- HR philosophy refers to a set of beliefs and assumptions of the management about people and their attitude towards work. Every organization has some HR philosophy which may be written or unwritten.
- Its implementation is more important rather than it being explicit. It acts as a guideline about how the people in the organization are to be treated. There are various techniques that have been adopted over the years.
- Today the human approach considers human beings as physical, psychological and social resource due to which each one of them becomes unique and different from others in terms of skills, abilities, knowledge and potential capacity.

**The HR philosophy is framed based on individual differences and based on the following beliefs:**

1. Human beings are the living resource and are tie greatest assets of the organization.
2. They can perform their best if given an opportunity to utilize their abilities.
3. They develop a deep sense of belongingness towards the organization if their needs are fulfilled.
4. If the sense of belongingness develops, they feel committed towards their work.
5. It is the responsibility of the organization to create a healthy work environment and provide a good quality of work life for all its members.

## HUMAN RESOURCE ACCOUNTING

American Accounting Association has defined Human Resource Accounting: "**It is the process of identifying and measuring data about human resources and communicating this information to interested parties**"

Human Resource accounting is a technique to measure the value of human assets and enable the effective management of human re-sources by providing information on their acquisition, utilization, retention and evaluation.

**Specific objectives of human resource accounting are as follows:**



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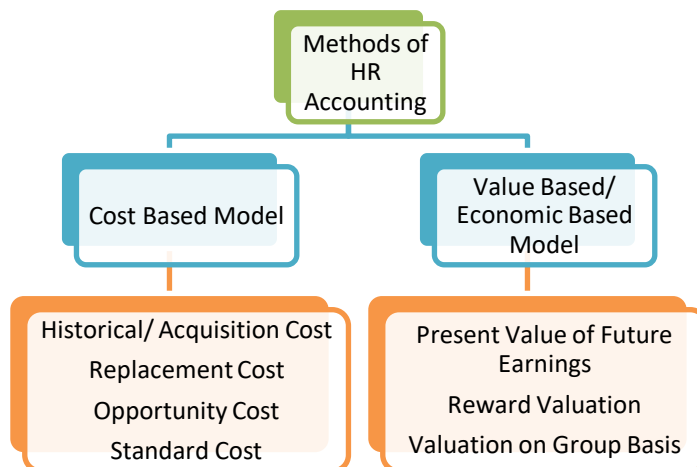
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1. To provide cost value data for managerial decisions regarding acquiring, developing, allocating and maintaining human resource so as to attain cost effective organizational objectives.
2. To provide information for effectiveness of human resource utilization.
3. To provide information for determining the status of human asset whether it is conserved properly; it is appreciating or depleting.
4. To assist in the development of effective human resource Management practices by classifying the financial consequences of these practices.

## Valuation of Human Assets — Methods:



**(Imp models: Historical cost method, replacement cost method, standard cost and present value of future earning)**

## Cost Based Models:

### 1. Historical Cost Method

- This approach was developed by William C. Pyle, which is based on the concept that there are certain cost incurred by the organisation with regard to human resources.
- Cost is a sacrifice aspect incurred to obtain some anticipated benefits or services. In this approach, actual cost incurred on recruiting, hiring, training and development of the human resources of the organisation are capitalized and amortized over the expected useful life of the human resources.



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- Historical cost is based on actual cost incurred on human resources. Such a cost may be of two types – acquisition cost and learning cost. Acquisition cost is the expense incurred on training and development. This method is very simple in its application but it does not reflect the true value of human assets.
- For example, an experienced employee may not require much training and, therefore, his value may appear to be below though his real value is much more than what is suggested by historical cost method.

## 2. Replacement Cost

- This approach was first opined by Rensis Likert and was developed by Eric G. Flamholth. Human resource of an organisation are to be valued on the assumption that a new similar organisation has to be created from cut down and what would be the cost to the firm if the existing resources were required to be replaced with other persons of equivalent talents and experience.
- This method takes into account the hypothetical cost required to procure a new employee on behalf of an old one. It not only includes procurement and training cost but also the other expenses which may be incurred if a true replacement is not easily found.
- As against historical cost method which takes into account the actual cost incurred on employees, replacement cost takes into account the national cost that may be required to acquire a new employee to replace the present one.
- In calculating the replacement cost, different types of expenses are taken into account which may be in the form of acquisition and learning cost. Replacement cost is generally much higher than the historical cost.
- For example, Friedman has estimated that the replacement cost of an executive in middle management level is about 1.5 to 2 times the current salary paid in that position.
- Replacement cost is much better indicator of value of human assets though it may present certain operational problems. For example, true replacement of a person may not be found easily with whose cost the valuation is done.

## 3. Opportunity Cost

- This approach analyses the alternative earning sources from the productive capacity of human resources by putting some alternative use.
- Opportunity cost is the value of an asset (HR) when there is an alternative use of it. The perspective chances of opportunity cost are declined for those employees that are not scarce. Opportunity cost is the value of an asset when there is an alternative use of it.
- There is no opportunity cost for those employees that are not scarce and also those at the top will not be available for auction.
- Opportunity costs represent the benefits an individual, investor or business *misses out on* when choosing one alternative over another.
- While financial reports do not show opportunity cost, business owners can use it to make educated decisions when they have multiple options before them. Bottlenecks are often a cause of opportunity costs.



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## Opportunity Cost Formula and Calculation

$$\text{Opportunity Cost} = \text{FO} - \text{CO}$$

**where:** FO=Return on best foregone option

CO=Return on chosen option

- The formula for calculating an opportunity cost is simply the difference between the expected returns of each option. Say that you have option A, to invest in the stock market hoping to generate capital gain returns. Option B is to reinvest your money back into the business, expecting that newer equipment will increase production efficiency, leading to lower operational expenses and a higher profit margin.
- Assume the expected return on investment in the stock market is 12 percent over the next year, and your company expects the equipment update to generate a 10 percent return over the same period. The opportunity cost of choosing the equipment over the stock market is (12% - 10%), which equals two percentage points.
- In other words, by investing in the business, you would forgo the opportunity to earn a higher return.

### 4. Standard Cost

- Similar to the method of standard cost applied to physical assets, a standard cost is assigned to each employee depending upon his position in the organizational structure.
- The employees are sorted into groups based on their positions before assigning such values to them.
- Instead of using historical or replacement cost, many companies use standard cost for the valuation of human assets just as its used for physical and financial assets. For using standard cost, employees of an organization are categorized into different groups based on their hierarchical positions.
- Standard cost is fixed for each category of employees and their value is calculated.
- This method is simple but does not take into account differences in employees put in the same group. In many cases, these differences may be quite vital.

### Value Based Models:

#### 1. Present Value of Future Earnings (Lev and Schwartz model)

- This model is developed by Lev and Schwartz and is popular in India.



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- This is also known as capitalization of salary method. Under this method the future earnings of an employee or grades of employees are estimated up to the age of retirement and are discounted at a rate appropriate to the person or the group in order to obtain the present value.
- In this method the future earnings of a group of employees are ascertained up to the age of retirement and converted to present value after discounting it at a predetermined rate.
- However this method does not give true value of human assets since it ignores their qualitative contributions towards achievement of organizational goals.

## 2. Stochastic Rewards Valuation Model

- The Flamholtz's stochastic rewards valuation model identifies the major variables which determine the value of an individual to the organisation.
- The model advocates that a person generates value for an organisation as he occupies and plays different roles and renders services to the organisation. .
- The movement of people from one organisational role to another is a stochastic process.
- As people move and occupy different organisational roles they render service (rewards) to the organisation.
- Based upon the above concept, a person's expected realisable value of an organisation can be measured as the discounted mathematical expectation of the monetary worth of the future rewards (services) a person is expected to render to the organisation in future roles he is expected to occupy, taking into consideration the probability of his remaining in the organisation.
- The model suggests a five step approach to assess the value of an individual to the organisation.
  - ◆ Forecasting the period a person will remain in the organisation i.e. his expected service life.
  - ◆ Identification of service states i.e. the roles he might occupy and the time at which he will quit the organisation.
  - ◆ Estimating the value derived by the organisation when a person occupies a particular position (service state) for specified time period.
  - ◆ Estimating the probability of occupying each possible mutually exclusive service state at specified future times.
- ◆ Discounting (at a specified predetermined rate) the expected service rewards to their present value.

## 3. Valuation on Group Basis (Jaggi and Lau)

- The model suggested by Jaggi and Lau is based on valuation of groups rather than individuals. A group implies homogeneous employees who may or may not belong to the same department or division.



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- It might be difficult to predict an individual's expected service tenure in the organisation or at a particular level or position, but on a group basis it is easier to ascertain the percentage of people in a particular group likely either to leave the firm during each of the forthcoming period, or to be promoted to higher levels.

## **Benefits of HRA**

1. It provides valuable data for determining so the appreciation or depletion in the value of human resources.
2. It provides cost- benefit analysis for making managerial decisions on acquisition, development, retention and utilization of human resources.
3. It provides information to evaluate the effectiveness utilization of human resources.
4. It enables the development of effective HR practices based on valuation of human assets.
5. It also provides data for devising a suitable promotion policy and good work environment for the people in the organization.

## **Disadvantages of HRA**

1. There is no standard practice for accounting of human resources.
2. Trade Unions may oppose this system.
3. The concept of HRA is based on assumption that the employee shall remain with the organization for a certain period of time. This assumption does not hold good today.
4. Valuation of human resources could lead to under-estimating the capacity of certain human resources and not valuing them appropriately.

## **IMPACT OF GLOBALIZATION ON HRM**

- Globalization symbolizes free flow of technology and human resources across national boundaries presenting an ever-changing and competitive business environment.
- Globalization is a process that is drawing people together from all nations of the world into a single community linked by the vast network of communication technologies.
- This aspect of globalization has also affected the HRM in the business world of today. HR managers today not need to rely in a small limited market to find the right employees needed to meet the global challenge, but today they can recruit the employees from around the world.





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- The future success of any organizations relies on the ability to manage a diverse body of talent that can bring innovative ideas, perspectives and views to their work. Thus, a HR manager needs to be mindful and may employ a ‘Think Global, Act Local’ approach in most circumstances.
- Many local HR managers have to undergo cultural-based Human Resource Management training to further their abilities to motivate a group of professional that are highly qualified but culturally diverse.
- Furthermore, the HR professional must assure the local professionals that these foreign talents are not a threat to their career advancement. In many ways, the effectiveness of workplace diversity management is dependent on the skilful balancing act of the HR manager.
- Global HRM refers to Human Resource Management practices that deal with managing a diversity of workforce from all around the world.

## THE IMPACT OF GLOBALIZATION ON HRM IS AS FOLLOWS:

- **Managing Cultural Diversity:** Managing different employees from different cultures in the same organisation is a complex activity. Employees from each country think differently, perceptions are different towards work culture, the languages change, vocabulary differs and even non verbal communications are quite different from each region. This makes the task of the human resource department challenging due to globalization.
- **Managing Expatriates:** Preparing the home country employees to work in a different country is a herculean task. The beliefs, value system, culture, attitude are diverse in nature. Recruiting, retaining and motivating expatriates have a major impact on the business. Understanding expatriate’s need is a prime concern for the human resource team.
- **Difference in the Employment Laws:** The employment laws or the labour laws differ from one country to another. The understanding of not only the monetary benefits becomes essential but also the non monetary benefits such as leaves, flexi timings are important to be included in the human resource policy.
- **Managing Outsourcing of employees:** Outsourced employees to manage business are the big impact of globalization. Managing the BPO, KPO employees working with a different culture, different language, working in completely opposite shifts is a new shift in the area of human resources. Managing the expectation of these employees is a challenge for today’s HR and this challenge is a result of globalization.
- **Managing virtual employees:** Majority of the information technology based organisations have employees working “on-site” at a client’s location which is completely new to them. The virtual employees have to be managed, retained and motivated in a different way unlike the “off-shore” employees. This practice of managing the virtual employees is a result of organisations going global.
- **Corporate Social Responsibility:** Corporate houses actively participating in the practice of doing for the betterment of the society has emerged from the western countries. It is one of the ways make the presence





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felt in the host countries. Employees are encouraged to participate in such activities which help to reduce stress working with MNC's.

- **Coping with flexible working hours:** The practice of flexible working hours has emerged as one of the retention initiative of workforce specially women employees who can maintain the work life balance. This practice of flexible working hours is result of working beyond normal time zones. Organisations which have a global presence need the attention of employees at various time zones which is not possible for all employees doing a continuous shift. Hence this practice emerged from globalization and has a positive impact on the HRM practice.
- **Evolution of more part-time and temporary work (especially among women, the elderly and students):** The concept of part time employment, contract jobs have emerged from the practice of MNC's since hundred percent of workforce on permanent payroll is quite a expensive matter to these organisations. Majority of large MNC's in the information technology sector has their employees under contract employment.
- **Coping up with emerging technologies & quality measures:** Every employee in today's leading organisation is being trained with the latest technologies especially with the ERP concept like SAP or Peoplesoft. This step has been taken by MNC's to equip the employees with latest technology enabling the employees to cope up with the changing technology. Certifications like Six Sigma are availed to employees to manage the business on an international platform.
- **Changing perspective from subordinates to business partners:** The shift has been observed in today's MNC that culture of subordinates is getting extinct. Employees have been treated as business partners' i.e every employee is responsible towards the growth of the organisation and considered as a partner in the company. This impact is the result of globalization.

## FACTORS INVOLVED IN THE CHANGING ENVIRONMENT OF HRM

The five factors involved in the changing environment of HRM are as follows:

1. Work force Diversity
2. Economic and Technological Change
3. Globalization
4. Organisational Restructuring
5. Changing Nature of Work

Business environment is changing environment and so is HR environment. The changing environment of HRM includes work force diversity, economic and technological change, globalisation, organisational restructuring, changes in the nature of jobs and work and so on.



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## 1. Work force Diversity:

- Diversity has been defined as any attribute that humans are likely to use to tell themselves, that person is different from me and, thus, includes such factors as race, gender, age, values, and cultural norms’.
- The Indian work force is characterized by such diversity that is deepening and spreading day by day.
- It is likely to be more diverse as women, minority- group members, and older workers flood the work force.
- Further, creating unanimity from a diverse work force has also become a challenge for HR manager.
- This is because, as several experts’ put it; diversity is marked by two fundamental and inconsistent realities operating today with it. One is that organisations claim they seek to maximize diversity in the work place, and maximize the capabilities of such a diverse work force.

## 2. Economic and Technological Change:

- Along with time, several economic and technological changes have occurred that have altered employment and occupational pattern.
- In India too, there is a perceptible shift in occupational structure from agriculture to industry to services.
- Technology has become the hallmark of the modern organisations. As such, modern organisations have become the technology-driven organisations. So to say, men are replaced by machinery.
- Manufacturing technology, for example, has changed to automation and robotisation.
- Manufacturing advances like these will eliminate many blue-collar jobs, replacing them with fewer but more highly skilled jobs. Similar changes are taking place in office automation, where personal computers, word processing, and management information system (MIS) continue to change the nature of office work.

## 3. Globalization:

- The New Economic Policy, 1991 has, among other things, globalised the Indian economy. There has been a growing tendency among business firms to extend their sales or manufacturing to new markets abroad. The rate of globalization in the past few years in India has been nothing short of phenomenal.



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- Globalization increases competition in the international business. Firms that formerly competed only with local firms, now have to compete with foreign firms/competitors. Thus, the world has become a global market where competition is a two-way street.
- Globalization has given genesis to the multinational corporations (MNCs). The MNCs are characterised by their cultural diversities, intensified competition, variations in business practices and so on. As an international business expert puts it, ‘the bottom line is that the growing integration of the world economy into a single, huge market place is increasing the intensity of competition in a wide range of manufacturing and service industries.
- Given these conditions, from tapping the global labour force to formulating selection, training and compensation policies for expatriate employees have posed major challenges for HRM in the next few years. This has underlined the need for studying and understanding HRM of multinational organisations or international organisations separately.

#### 4. Organisational Restructuring:

- Organisational restructuring is used to make the organisation competitive. From this point of view, mergers and acquisitions of firms have become common forms of restructuring to ensure organisational competitiveness. The mega-mergers in the banking, telecommunications and petroleum companies have been very visible in our country. Downsizing is yet another form of organisational restructuring.
- As a part of the organisational changes, many organisations have “rightsized” themselves by various ways like eliminating layers of managers, closing facilities, merging with other organisations, or out placing workers.
- There has been a practice to flatten organisations by removing several layers of management and to improve productivity, quality, and service while also reducing costs. Whatever be the form of restructuring, jobs are redesigned and people affected.

#### 5. Changing Nature of Work:

- Along with changes in technology and globalization, the nature of jobs and work has also changed. For example, technological changes like introduction of fax machines, information technology, and personal computers have allowed companies to relocate operations to locations with lower wages.
- There is also a trend toward increased use of temporary or part-time workers in organisations.



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- One most significant change in the nature of work is that it has changed from manual to mental/knowledge work. In this context, the management expert Peter Drucker's views are worth citing.
- He said that the typical business will soon bear little resemblance to the typical manufacturing company of 30 years ago.

## WORKFORCE DIVERSITY

According to *Workology*, workforce diversity “is the bringing together of a variety of people to one workplace.” It's a concept that does something that many other business-related concepts don't – it diverges from the professional and fundamentally concerns the *personal*.

- Managing workforce diversity implies creating an organisational climate in which a heterogeneous workforce performs to its best potential; without the organisation favouring /dis-favouring any particular segment of workforce with a view to facilitating the best attainment of organisational goals.

## Features of Workforce Diversity

- (i) Workforce diversity management requires creation of an organisational climate, in which people from different cultural, social backgrounds and being diverse in many other respects (e.g. age, gender, education etc.) can co-exist and work, with full co-operation of one another.
- (ii) Workforce diversity management aims at making people work to the best of their potential
- (iii) Workforce diversity management rules out any discrimination among people, in any respect, whatsoever.
- (iv) Work-force diversity management is expected to work towards the best attainment of organisational goals.

## Dimensions of Workforce Diversity

### (i) Age:

People belonging to different age groups cause diversity in workforce. Young people may be enriched with health, merit, capacity for hard-work etc.; while elderly people may possess more maturity than their junior counterparts and are full of experiences of life.



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## (ii) Gender:

Male workers are usually aggressive, bold and materialistic; while female workers possess sympathy for others and are more concerned with quality of life. What is important to observe is that people of both gender have material differences in outlook, nature, habits etc.; as differences between males and females are the design of God who created mankind.

## (iii) Education:

In an organisation people may range from less educated to highly educated. Educated people have a broad outlook and are open-minded. They are endowed with logic and rationality and usually dislike discrimination among individuals on petty grounds of caste, colour, religion etc.

## (iv) Culture:

Culture is a complex of race, religion, language, social traditions and values etc. People from different cultural backgrounds may have ethnic orientations i.e. a sense of favoritism towards their nation, race or tribe, which they belong to.

## (v) Psychology:

(Psychology is the kind of mind that one has that makes one think or behaves in a particular way). In a organisation, there are people with different psychology. Some may be optimistic or pessimistic; some may be bold or timid or so on. Psychology may be a gift of Nature or a manifestation of family background or social affiliations.

**Topic: Mention the significance/ importance of workforce diversity.**

## Significance of Workforce Diversity Management:

**Workforce diversity management is significant for the following reasons:**

### (i) Ability to Deal with Diverse Market:

Culturally diverse workforce can better appreciate the needs, feedings, and attitudes of culturally diverse consumers. Thus workforce diversity increases the competence of a corporation to deal with a market; that consists of diverse consumer groups in respect of age, gender, culture etc.

### (ii) Better Decision-Making:

People from heterogeneous backgrounds may aid management in better decision-making, by offering suggestions from a wide range of perspectives and orientations. In fact, heterogeneous groups of people may be more creative and innovative; when they pool their knowledge and experiences and agree on a common solution to a tricky problem; which might aid management in making excellent decisions for the organisation.



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## **(i) Better Human Relations:**

Workforce diversity management aims at developing and nurturing a common organisational culture and climate; which enable people from diverse culture and backgrounds to co-exist peacefully. Such a common organisational culture and climate leads to better human relations in the enterprise and produces all-round organisational and managerial efficiency.

## **(ii) Preventing Unnecessary Labour Turnover:**

When in an organisation there is good workforce diversity management; women and other dis-satisfied people are prevented from leaving the organisation. In case otherwise, when there is large labour turnover because of poor workforce diversity management; investment made in manpower may go waste, with other bad consequences for the organisation. In fact, employees leave the organisation when they do not feel comfortable and duly cared for by management.

## **(iii) Building of Goodwill of the Enterprise:**

Companies with excellent workforce diversity management build goodwill in the society. As such, talented people of society with diverse backgrounds and culture get attracted towards it for seeking suitable employment. Such companies never have a problem of the scarcity of skilled, educated and talented human capital.

## **TECHNIQUES OF WORKFORCE DIVERSITY MANAGEMENT:**

**Some techniques for successful workforce diversity management are suggested below:**

### **(i) Creating Awareness of Diversity:**

Management must create awareness in the organisation that differences among people as to age, gender, education, culture etc. exist in workforce; so that people may try to understand one another in a more rational and friendly manner.

### **(ii) Creating Conditions for Common Organisational Culture:**

Organisation must develop cross-cultural training programmes creating conditions for development of a common organisational culture and climate. Such common culture will create an environment in which a diversified work force can co-exist comfortably, peacefully and happily.

### **(iii) Programmes of Special Care for Diversified Workforce:**

Management must design programmes of special care, like the following:

1. Care for elderly people





# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

2.Special work schedules to provide convenience to female workers etc.

## (iv) Career Development Programmes:

There must be programmes for identifying each individual's strengths, weaknesses and potential for career development; so that the organization can capitalize on the peculiar features of a diversified workforce. In fact, people should be valued for their difference and variety.

## (v) Avoiding Discriminations:

A very significant technique for excellent workforce diversity management is to avoid any sort of discrimination among people on the basis of age, culture and specially gender. In the most developed country the U.S.A, the Glass Ceiling Commission states that between 95 and 97 percent of senior managers in the country's biggest corporations are men.

(The term 'glass ceiling' describes the process by which women are barred from promotion by means of an invisible barrier).

## (vi) Prevention of Sexual Harassment:

With the entry of a large number of women in organisations, the phenomenon of sexual harassment is usually witnessed; which management must prevent by all means and at all costs. Sexual harassment includes a range of actions, like – unwelcome touching, joking, teasing, innuendoes (indirectly bad and rude remarks), slurs, and the display of sexually explicit materials.

## (vii) Committees of Diverse Members:

Committees of diverse members must be formed for evaluating and addressing complaints of people, regarding their sad experience of working in the organisation.

## CORPORATE DOWNSIZING

- Downsizing is when companies terminate multiple employees at the same time, often to save money. As opposed to termination for cause, downsizing is typically not due to any conduct on the part of the employee.
- Other words for downsizing include: layoffs/laying off, reduction in force, making redundant.
- Corporate downsizing can occur for a number of reasons, like a slump in profits, plant closure, or business acquisition.
- And unlike common belief, it typically has *nothing* to do with employees' performance. Rather, it's a strategic business move to cut operational costs, maximize production, and increase profit.





# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## Alternative workforce reduction methods

HR should explore alternative workforce reduction methods before settling on corporate downsizing:

- **Voluntary layoffs.** Motivate employees to volunteer to leave your organization with incentives.
- **Early retirement.** Offer early retirement to eligible employees with financial incentives.
- **Furloughs.** Place employees to go on temporary, unpaid leave until financial woes pass.
- **Hiring freeze.** Stop hiring for a position that is not critical for business to continue.
- **Pay reduction.** Reduce pay rates, fringe benefits, or work hours of willing employees.

## Selection criteria for Corporate Downsizing

This is probably the single most important – *and difficult* – process of corporate downsizing.

**Seniority.** The rule here is that the last to join are the first to go. This is a great way to protect yourself against discrimination suits and it simplifies the layoff process. Nevertheless, by using this method for conducting layoffs, you risk laying off employees that are a huge company asset.

**Employee status.** This method prefers full-time employees remaining in employment over part-time and contract employees. Using this method will keep your employer brand intact because part-time and contractual roles are usually considered more expendable. However, if your business relies on outsourcing, then this might not be the best solution.

**Performance.** Selecting employees based on their performance is a favorite among management teams since it aims to weed out weak talent. But it is risky to carry out successfully because of the subjectivity involved. Therefore, you need to be extra careful in using performance as the sole criteria for your layoff process. Doing so can result in a lawsuit.

**Skills.** Choose between employees based on their skill set. Namely, distinguish between skills that are pivotal to your company's success and skills that are not. By doing so, you get to retain top talent without sacrificing on quality.

**Multiple selection criteria.** This is the most effective layoff selection method. Create a list of criteria with different weights that best meet your company downsizing goals. Then rank employees according to these criteria. The ones with the lowest 'score' will be laid off. It's a combination of the previous selection methods but customized to fit your organization's needs.



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3- Vaishalinagar  
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Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## TECHNOLOGICAL ADVANCES IN HRM:

- **Technological advancement** can have a huge impact on the HR department of an organization.
- It allows the company to improve its internal processes, core competencies, relevant markets and organizational structure as a whole.
- Human Resource must mainly be focused on the strategic objectives of the organization.

The latest trends that are redefining HR include big data, mobile apps, social media, cloud technology, and the SaaS (Software as a Service) business model. These digital disruptors are bringing major changes to the human resources industry as they impact how organizations manage their workforce, hire new employees, comply with regulations, and handle HR data.

### Technological Trends Redefining HR

1. Big Data Powers Organizations
2. Mobile Apps are the Future
3. Social Media – A Powerful Tool
4. Cloud Technology & SaaS
5. Bring Your Own Technology (BYOT)
6. Wearable Technology

## CULTURAL ENVIRONMENT IN HRM

- The cultural and social environment includes such things as work ethic, attitude towards work and employee motivations.
- For example, monetary rewards may be valued highly in some cultures, while a greater work-life balance is valued in other cultures.
- HRM must assess these cultural factors and match motivators accordingly. If money is king, direct financial compensation in the form of high wages may suffice.
- However, if work-life balance is more important, a generous vacation and paid leave package may be more motivating.
- A society's social and ethical views of the role of business in society will also influence how HRM operates. For example, once upon a time, child labor was not considered unethical.
- Now, not only is it considered unethical, but it's also illegal.

### Different Countries have different set of:

- ▣ Values



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

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2 – Vaishalinagar  
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Raiya Road, Rajkot - 360001  
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- Morals
- Customs
- Political, economic and legal system

Now days, human resource is considered the most significant and difference making aspect of organizations and number of activities are undertaken, and lots of programs are implemented to increase the productivity of employees by supporting and accommodating employees ever changing needs.

In this regard, the importance of organizational culture has increased manifold. Number of studies has been taken to assess the impact of culture on human resource management. Corporate culture and national culture both have impact on organization and so on the employee's performance. Multinational companies are busy promoting corporate culture improving control, integrating and coordinating their subsidiaries spread over the entire globe.

Organization uses its culture to have control over its subsidiaries. It serves to control the behavior of employees, inculcating them values and norms that tend to produce the desired results. In fact, corporate culture is managed by means of HRM practices. So in this way "like minded" individuals are become part of organization through socialization by providing them training and personal interaction.

This training aims to develop strong organizational commitment by means of different human resource policies like stock option plans, job security, recreational and house accommodation facilities etc and many excellent companies like IBM, HP frequently use these methods. However some of these practices may fail to provide the appropriate space for values and norms and beliefs of the local environment where the subsidiary operates. This demands attention to be paid to avoid conflict between national and corporate culture.

## **CHANGING SKILL REQUIREMENT IN HRM:**

Human resource professionals are one-of-a-kind. They have a certain set of skills that only HR professionals have, which is what makes them so special. In today's post, we will discuss the five essential human resource management skills needed to run a successful human resource department and hire the best talent on the market today.

### **Organization**

One of the most important human resource management skills you must have to successfully work in HR is organization. Everyone who works in HR must be well-organized, must have strong time management and be personally efficient in order to succeed. This means that their office cannot be in shambles. Paperwork must always be filed correctly, especially when it comes to personnel files of employees.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## **Negotiation**

The second essential human resource management skill that all HR professionals need to be successful is that of the ability to negotiate. When negotiation rolls around when an offer of employment has been extended, there typically are two differing sides. A strong HR professional will be able to work with both sides so an agreement can be reached that makes everyone involved happy.

## **Problem Solving and Conflict Management**

The third essential human resource management skill on our list is a combination of two items; problem solving and conflict management. It is a given that not every single employee in your office will get along with their co-workers or their managers. This means that at some point, you will need to solve problems or manage conflicts. The most effective HR manager will be able to ensure that employees work together in a civil manner so work can be completed on-time and with high quality.

## **Communication**

Communication is key in every single workplace, but it is very important in the skillset of the HR professional. If an HR manager cannot communicate to upper-level managers, to employees and to shareholders, then the company will not succeed. The communication done by HR managers is not one-fold. There are many methods of communication used by HR managers today. These include writing, speaking in front of small and large groups of people and through social media.

## **Multitasking**

Multitasking is the fifth essential skill needed by HR managers in order to be successful today. The HR manager is inundated with a variety of issues, questions and requests on a daily basis. Some of them might relate to others and some will be completely different issues altogether. HR managers must know how to adapt to change in the office if they want to be successful. This is part of multitasking because they will need handle an issue with an employee while also implementing a new policy from the higher-ups.

## **CHANGING EMPLOYEE EXPECTATIONS:**

- Employers must adapt to changing employee expectations
- Countless factors can influence the steps people take in their lives, in particular when they decide to resign from their job and move elsewhere.
- For instance, some may be struggling with expensive childcare costs, while others might find it hard to get on the housing ladder. On the other hand, some people might be frustrated with a long commute to work each day.



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2 – Vaishalinagar  
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- It therefore pays for employers to be conscious of the day-to-day pressures their staff may be facing and do all they can to make it a bit easier for them. After all, it could be crucial in preventing their top talent from handing in their notice and moving elsewhere.

## **EXPECTATIONS FROM EMPLOYEES AND SOME EXPECTATIONS OF EMPLOYEES**

### **Some expectations from employees in the 21st century are as follows:**

1. Report to work as scheduled and seek approval from their supervisors in advance for any changes to the established work schedule, including the use of leave and late or early arrival and departures.
2. Perform assigned duties and responsibilities with the highest work etiquette.
3. Devote full effort to job responsibilities during work hours.
4. Maintain the qualifications, certification, licensure, and/or training requirements identified for their positions.
5. Demonstrate respect for fellow employees and toward coworkers, supervisors, managers, subordinates, students, and customers.
6. Use state equipment, time, and resources judiciously and as authorised.
7. Support efforts that ensure a safe and healthy work environment.
8. Utilise leave and related employee benefits in the manner for which they were intended.
9. Resolve work-related issues and disputes in a professional manner and through established business procedures.
10. Meet or exceed established job performance expectations.
11. Make work-related decisions and/or take actions that are in the best interest of the workplace.
12. Report circumstances or concerns that may affect satisfactory work performance to management, including any inappropriate (fraudulent, illegal, unethical) activities of other employees.

### **Some expectations of employees**

- Clean and ventilated work environment
- Safe working conditions
- Proper and timely financial rewards
- Consideration of complaints and queries
- Treatment of fairness and equality
- Providing flexibility in working conditions
- Proper training and development
- Good and amiable working atmosphere with co workers



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## QUALITIES OF HR MANAGER

### 8 Key Qualities of an HR Manager

- Sympathetic Attitude
- Quick Decisions
- Integrity
- Patience
- Formal Authority
- Leadership
- Social Responsibility
- Good Communication Skills

### **Sympathetic Attitude**

A good personnel manager must have a humane approach to human resource problems. Regardless of the problems faced by the employees, he must have a sympathetic attitude while dealing with them.

### **Quick Decisions**

He should display the ability to take quick decisions. Let's assume that there is a conflict between a superior and an employee in the organization. When the HR manager tries to mediate and put an end to the conflict, he might have to make some quick decisions. He should be mentally alert and therefore not get caught unawares.

### **Integrity**

Being the head of the personnel or human resource department, an HR manager should display integrity. Honesty and frankness are the hallmarks of a good human resource manager. At no time can the employees doubt the integrity of the personnel manager.

### **Patience**



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

He should be extremely patient and not someone who loses his temper easily. While dealing with employees, it is important to be a good listener, especially when an employee is voicing his concerns. And good listening skills require a lot of patience.

Further, since employees tend to talk to the HR manager about their problems, they can get agitated and verbally abusive. In such situations, it is imperative that the HR manager keeps his cool and controls the situation.

## **Formal Authority**

He should depend on his formal authority alone. In fact, an effective HR manager earns his informal authority of influencing people through his interpersonal skills.

## **Leadership**

Good leadership skills are essential to guide the employees towards achieving the organization's objectives. He should also keep people motivated and encourage them to use their skills for the overall good of the enterprise.

## **Social Responsibility**

He should have a sense of social responsibility. Further, he must encourage employees to discharge their social obligations to different segments of society. After all, a good human resource manager isn't only about the organization. He also needs to look at the broader human resource element.

## **Good Communication Skills**

Another essential quality of a human resource manager is that he must possess good communication skills. In fact, since a major part of his role involves interacting with employees, unions, and management, being a good communicator is a must.





# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## UNIT – 2

### ACQUISITION OF HUMAN RESOURCES

#### HUMAN RESOURCE PLANNING

- Human resource is very important of all the resources that are available in the organization. The utilization of all resources depends on human resource.
- Thus, the efficiency and productivity of the organization would directly be in proportion to the type and nature of human resource available at the disposal of the company. Therefore, human resource management and human resource planning acquire special managerial attention and importance.
- Human resource planning (HRP) is the continuous process of systematic planning ahead to achieve optimum use of an organization's most valuable asset—quality employees. Human resources planning ensures the best fit between employees and jobs while avoiding manpower shortages or surpluses.

#### There are four key steps to the HRP process. They include

- ▶ analyzing present labor supply,
- ▶ forecasting labor demand,
- ▶ balancing projected labor demand with supply, and
- ▶ supporting organizational goals.

HRP is an important investment for any business as it allows companies to remain both productive and profitable.

Human resource planning (HRP) is a strategy used by a company to maintain a steady stream of skilled employees while avoiding employee shortages or surpluses. Having a good HRP strategy in place can mean productivity and profitability for a company. Human resource planning allows companies to plan ahead so they can maintain a steady supply of skilled employees. That's why it is also referred to as workforce planning. The process is used to help companies evaluate their needs and to plan ahead to meet those needs. Human resource planning needs to be flexible enough to meet short-term staffing challenges while adapting to changing conditions in the business environment over the longer term. HRP starts by assessing and auditing the current capacity of human resources.

Planning is determining future course of action. Human resource planning pertains to determining future requirement of human resource in terms of quality as well as quantity.

#### Definitions:

‘Manpower planning or human resource planning is the process of determining manpower requirements and the means for meeting those requirements in order to carry out the integrated plan of the organization.’



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

"Human resource planning is the process by which an organization should move from its current manpower position to its desired manpower position. Through planning, management strives to have the right number and right kind of people at the right place at the right time, doing things which result in both the organization and the individual receiving maximum long-run benefit."

**According to Wickstrom, human resource planning consists of the following series of activities:**

1. To forecast future manpower requirement with the help of suitable forecasting techniques.
2. To take stock of the available manpower and to check their level of utilization.
3. To match present employees and future requirements and to find the qualitative as well as quantitative gap.
4. To plan programmes of selection, recruitment, promotion, transfer, development, training, etc to fill the gap and to ensure the fulfillment of future requirement.

In simple words, manpower planning is making provision for right kind and right number of employees to perform various duties so as to achieve organizational objectives as well as to fulfill individual requirements of the employees.

## **Process of HRP:**

- Analysis of Organizational Strategy
- Estimation of Human Resource Demand
- Forecasting of Human Resource Supply
- Estimation of Net Human Resource Requirement (Net human Resource Requirement = Future Demand — Net Future Supply)
- Managing Surplus of Human Resource

Relocation

Retrenchment

- Managing Deficit of Human Resource

Internal Plan (Promotion, Transfer, T & D, Retention)

External Plan (Outsourcing, Recruitment and Selection)

- Revising Organizational Plan and Strategy

1. **Analysis of Organizational Strategy:** The very first step in the process of HRP is to study and analyze corporate level strategy. Company's strategy could be of merger, amalgamation, diversification, expansion, etc. Functional level strategies are to be determined in accordance to the overall strategy.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

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Basically, human resource strategy pertains to making provision for the required employees, in terms of quantity as well as quality, to implement corporate level strategy. Thus, organizational strategy provides the base for developing human resource plan.

2. **Estimation of Human Resource Demand:** Requirement is to be estimated in terms of number that how many employees would be needed to implement corporate strategy. Same way estimation is to be done for the type of employees needed in terms of required skills and knowledge. Job design and job analysis helps in estimating future requirement of human resources. There are several methods with the help of which demand for human resource is estimated. The widely used methods are managerial judgment, statistical techniques like ratio trend analysis and econometric models, work study techniques, etc
3. **Forecasting of Human Resource Supply:** The very first step in the exercise estimating future supply of human resource is to take stock of existing human resource inventory. The present stock of inventory is checked total number wise, department wise, designation wise, etc. It involves following steps: -
  - a) Total number of employees is counted.
  - b) Number is counted department-wise, designation-wise, salary-wise, skill-wise, etc.
  - c) Job categories are developed on the basis of some criteria so as to put similar jobs in one category and then number is counted in each category. Categories are developed on the basis of skill requirement, nature of job, etc.
  - d) Job categories are developed on the basis of age. Then number and nature of employees are counted in each category.

After taking the stock of existing employees, future supply of employees is calculated considering potential additions and potential losses in the present stock of employees.

4. **Estimation of Net Human Resource Requirement:** Net human resource requirement is estimated taking into consideration future demand and net future supply of the employees. This requirement is to be estimated number-wise and nature-wise. Net human Resource Requirement = Future Demand — Net Future Supply.
5. **Managing Surplus of Human Resource:** If estimation shows surplus of human resources in the whole organization or in any department or unit, accordingly plan is developed to adjust the employees. If surplus is estimated in some departments, only, then some employees can be shifted to other departments by way of promotion, transfer or demotion to the extent possible. If the surplus is estimated in the whole organization, plan is made for the retrenchment of the employees. But it has to be done in the consultation with the trade unions. Thus, there are two possibilities: Retrenchment and Redeployment or Relocation.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

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## (a) Relocation of Employees

Several programmes can be designed for the employees that are going to become surplus in time to come.

- Such employees are identified and career guidance and training is planned for them so that either they can be placed in some other departments of the same organization or they can be helped in making themselves fit to take up jobs outside the organization. They can be given guidance for writing resume and for facing the interview.
- The surplus employees can be given job in the sister concerns, if possible.
- If the vacancies are there for almost similar kind of job in other organization, then HR manager would help surplus employees in getting employment in such other firms.

## (b) Retrenchment/ Cutback

There are several possible plans that can be formulated for reducing the number of employees in the organization when they have become surplus in the whole organization.

### (i) Sharing the work:

Employees can be asked to share the jobs wherever possible so that the surplus employees can be accommodated and to that extent the burden of other employees would reduce. This solves the problem of excess employees only in the short run.

### (ii) Reduction in working hours:

Work burden of each employee can be reduced and each one of them can be asked to work for less number of hours so that the employees that have become extra can be given that part of the job.

### (iii) Leave without pay policy:

Surplus employees can go for leave without pay so that the company can reduce the cost of labor and the employees can be given time to prepare themselves for taking up job somewhere else after some time. Here, employees are given time to make them fit and ready for the upcoming changes.

### (iv) Temporary or Permanent layoff:



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In case of temporary layoff, employees are asked not to come to work place only for the temporary time period. Such layoffs take place due to such reasons like machine breakdown, temporary material non-availability, power failure, etc. When firm comes back to its normal position, it calls employees back for resuming their duties. Permanent layoff takes place when the company closes its business permanently.

## (v) Early Retirement:

Some employees can be offered the scheme of getting retired early, i.e., before the actual due date of retirement. If excess supply of human resource over its demand in future is estimated, then employees can be offered this option. They can be given some extra cash benefit over and above the regular retirement benefits. This is also known as voluntary retirement scheme. This was first introduced by Indian government to solve the problem of excess labour in the public enterprises.

## (vi) Attrition:

When the excess of supply over demand is estimated, then the policy of attrition is followed wherein positions that get vacant are not filled so that there will not be addition to existing workforce in the organization so as to avoid the problem in future. When employees leave the organization for different reasons, their positions are not intentionally filled with new employees so that the problem of overstaffing would not take place in future.

## (vii) Forced Retirement:

In case of compulsory retirement, extra employees are identified and they are asked to leave the job compulsorily. They are not left with any choice but to retire. They are given regular retirement benefits but no extra benefits are given to them. This is known as Iron Handshake.

## (viii) Creation of Ad hoc Positions:

At times, companies create temporary/ad hoc jobs just to retain some extra employees so that they do not lose their employment immediately or in short run.

**6. Managing Deficit of Human Resource:** If the estimation says that there will be deficit in future so far as human resource is concerned either in the whole organization or in any part/department of the organization, planning should be done to fill the gap. First the possible availability of employees from the internal sources is checked and if the requirement cannot be fulfilled from the internal sources then the external sources are explored.



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## (a) Internal Plan:

Future supply of the employees from the internal sources is estimated and if it is possible to fill the gap with the help of internal candidates, then accordingly planning is done for the internal mobility and advancement of the employees in the organization. It covers mainly following plans:

### ➤ **Promotion Plan:**

If there is possibility of filling future vacancies with the help of employees within the organization, promotion plan can be formulated whereby, promotion criteria, promotion hierarchy special reservations in promotion, etc can be finalized.

### ➤ **Transfer Plan:**

Transfer is another way to fill the vacancies from the internal source. There are two types of transfers: company initiated transfers and employee initiated transfers. The company has to chalk out clear plan for both the types of transfers.

### ➤ **Training and Development Plan:**

Comprehensive training plan is to be formulated covering different aspects. First major decision is to be taken regarding in house training or outside/institute training. In case of first option, other things to be decided are: making provision for trainers, developing and preparing training materials and courses keeping in view the present skills of the employees and future job requirements, designing training techniques, etc. In case of second option, selection of an appropriate institute is to be done.

### ➤ **Retention Plan:**

A well-thought out plan is to be developed for retaining existing employees in the organization so that future deficit can be met. There always remains scarcity of employees in some job categories. Retention strategy has to be very strong particularly in such areas to avoid difficulties in future.

## (b) External Plan:

### ➤ **Outsourcing Plan:**

Some outsourcing organizations keep stock of employee having skills and qualifications. Such professional organizations can provide employees on demand to different companies. The services of these employees can be availed as per the requirement. The outsourcing organization earns commission for providing the service.

### ➤ **Recruitment and Selection Plan:**





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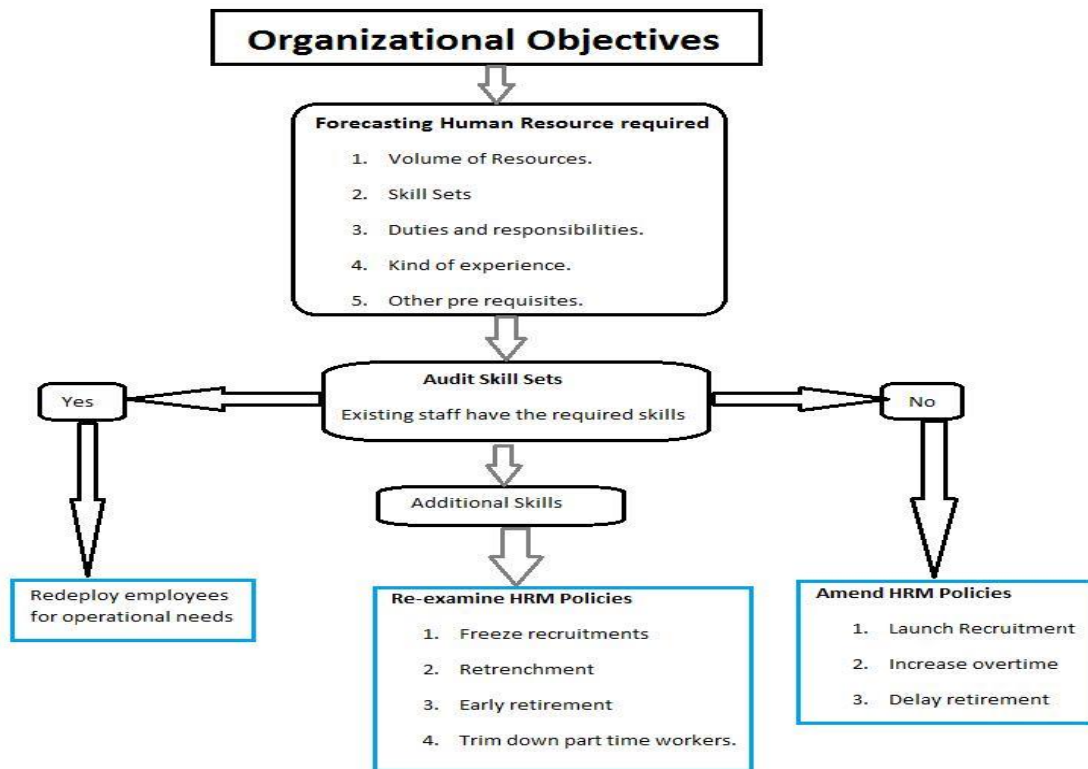
(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

Definite plan has to be prepared for recruitment and selection of employees. It covers several aspects like deciding nature of employees needed, number of employees required of each type, the time would be needed, exploring all possible sources of recruitment, techniques to be used for recruitment and selection, etc.

7. **Revising Organizational Plan and Strategy:** Organizational plan is to be changed if it is concluded that future requirements cannot be fulfilled fully after considering all possible sources. The Overall Plan is to be altered keeping in view future scarcity of human resource.



## OBJECTIVES OF HRP

- ▶ Guarantee ample supply of resources, whenever there is a need for it.
- ▶ Make sure that the current manpower in the company is being used properly.
- ▶ To foresee the potential requirements of manpower at various skill levels.
- ▶ Evaluate excess or scarcity of resources that are available at a given point of time.
- ▶ Predict the impact of technological changes on the resources as well as on the kind of jobs they do.
- ▶ Manage the resources that are already employed in the organization.
- ▶ Ensure that there is a lead time available to pick and train any supplementary human resource.





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## SIGNIFICANCE OF HRP

- ▶ It gives the company the right kind of workforce at the right time frame and in right figures.
- ▶ In striking a balance between demand-for and supply-of resources, HRP helps in the optimum usage of resources and also in reducing the labor cost.
- ▶ Cautiously forecasting the future helps to supervise manpower in a better way, thus pitfalls can be avoided.
- ▶ It helps the organization to develop a succession plan for all its employees. In this way, it creates a way for internal promotions.
- ▶ It compels the organization to evaluate the weaknesses and strengths of personnel thereby making the management to take remedial measures.
- ▶ The organization as a whole is benefited when it comes to increase in productivity, profit, skills, etc., thus giving an edge over its competitors.

## NEED FOR HRP

- ▶ In India, unemployment is a grave concern. Scarcity of manpower and that too with the required skill sets and competence, has given rise for need of Human Resource Planning.
- ▶ It comes handy for smooth and continuous supply of workers when a huge number of employees is retiring, or leaving the company or maybe they are incapable of working due to psychological or physical ailments.
- ▶ There is a need for Human Resource Planning when there is an increase in employee turnover, which is obvious. Some examples of this turnover are promotions, marriages, end of contract, etc.
- ▶ Technological changes lead to a chain of changes in the organization, right from skill sets product methods and administration techniques. These changes lead to an overall change in the number of employees required and with entirely different skill set. It is here that the Human Resource Planning helps the organization deal with the necessary changes.
- ▶ Human Resource Planning is required to meet the requirements of diversification and growth of a company.
- ▶ There is a need for Human Resource Planning in downsizing the resources when there is a shortage of manpower. Similarly, in case of excess resources, it helps in redeploying them in other projects of the company.

## JOB ANALYSIS:

The knowledge of job is very much important for performing major personnel functions like manpower planning, recruitment and, selection. Moreover, standards for the best performance of the job are to be



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established against which the applicants' qualification, skills are compared and accordingly decision can be taken for putting the most suitable employees on different job positions.

## Concept:

- ▶ Job analysis is the process of gathering and analyzing information about the content and the human requirements of jobs, as well as, the context in which jobs are performed. This process is used to determine placement of jobs.
- ▶ Job analysis defines the organization of jobs within a job family. It allows units to identify paths of job progression for employees interested in improving their opportunities for career advancement and increasing compensation.
- ▶ Job analysis, contains a simple term called "analysis", which means detailed study or examination of something (job) in order to understand more about it (job). Therefore job analysis is to understand more about a specific job in order to optimise it. Job analysis is a systematic process of collecting complete information pertaining to a job. Job analysis is done by job analyst who is an officer have been trained for it.

## Job analysis is a detailed examination of

- (1) tasks that make up a job (employee role),
- (2) conditions under which an employee performing his/her job, and
- (3) what exactly a job requires in terms of aptitudes (potential for achievement), attitudes (behavior characteristics), knowledge, skills, educational qualifications and the physical working condition of the employee.

## Its objectives include

- (a) to determine most effective methods for performing a job.
- (b) to increase employee job satisfaction.
- (c) to identify core areas for giving training to employees and to find out best methods of training.
- (d) development of performance measurement systems, and
- (e) to match job-specifications with employee specifications while selection of an employee.

## Definitions:

- ▶ In the words of **Dale Yoder**. "A Job is a collection of duties, tasks and responsibilities which are assigned to an individual and which is different from other assignment"
- ▶ According to **Michael J. Jucius**, "Job analysis refers to the process of studying the operations, duties and organisational aspects of jobs in order to derive specification or, as they are called by some job description"



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- ▶ In the words of **Edwin B. Flippo**, "Job analysis is the process of studying and collecting information relating to the operations and responsibilities of a specific job."
- ▶ **According to Blum**, "A job analysis is an accurate study of the various components of a job. It is concerned not only with an analysis of the duties and conditions of work, but also with the individual qualifications of the worker."
- ▶ In the words of **Scott, Clothier and Spriegel**, "Job analysis is the process of critically evaluating the operations, duties and relationship of the job."

It is a complete and detailed study of the job. It is like a post mortem analysis the job. It is a procedure by which all the relevant information regarding job.

It is a systematic study with the help of which tasks, duties and responsibilities are identified. In other words, the process of collecting information relating to operations and responsibilities of a specific job is called Job analysis.

The process of determining, by observation and study and reporting information relating to the nature of the specific job. It is the determination of the tasks which comprise the job and of the skills, knowledge, abilities and responsibilities required of the worker.

## **Job analysis attempts to collect following information:**

1. What all activities a worker has to perform, their timings are motives behind each activity.
2. Job requirements and expected human behavior.
3. Use of machines, tools, equipments and other ancillary aids used.
4. Standards of performance in terms of quantity, quality and speed.
5. The framework within which the job is to be performed like working conditions, motivation for work, etc.

In simple words, job analysis is the description of the complete job. It covers the conditions under which the job is to be performed, the main duties and responsibilities, the number and nature of tasks involved, qualifications and skills required in the, performance, other service conditions like working hours, opportunities for advancements and pay, the relation with other jobs etc.

There are two major parts of job analysis: Job Description and Job Specification

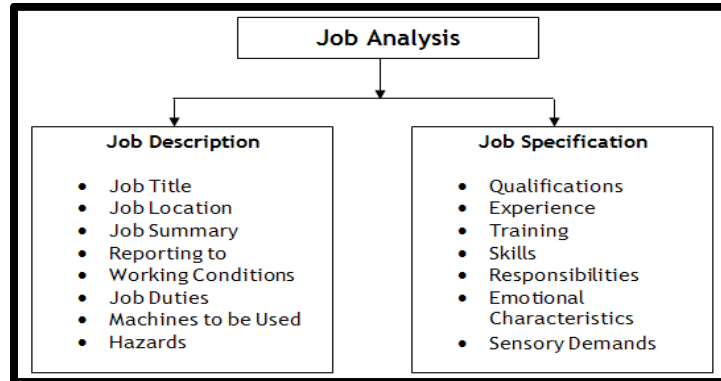


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## 1. Job Description:

It contains the details of the job like its title, the place of job performance, working condition and responsibilities and duties. It states what is to be done, how is to be done and why it is to be done. It describes the formal and correct contents of the job.

Job description includes basic job-related data that is useful to advertise a specific job and attract a pool of talent. It includes information such as job title, job location, reporting to and of employees, job summary, nature and objectives of a job, tasks and duties to be performed, working conditions, machines, tools and equipment to be used by a prospective worker and hazards involved in it.

### Purpose of Job Description

- ▶ The main purpose of job description is to collect job-related data in order to advertise for a particular job. It helps in attracting, targeting, recruiting and selecting the right candidate for the right job.
- ▶ It is done to determine what needs to be delivered in a particular job. It clarifies what employees are supposed to do if selected for that particular job opening.
- ▶ It gives recruiting staff a clear view what kind of candidate is required by a particular department or division to perform a specific task or job.
- ▶ It also clarifies who will report to whom.

### Primary Contents of Job Description:

- Job title
- Location
- Job summary
- Supervision given or received
- Duties
- Materials, machines, tools and equipment
- Working conditions and hazards
- T & D facilities



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- Chances and channels of promotion

## 2. Job specification:

It is a statement showing the human qualities and qualifications required for the acceptable performance in any specific job. It describes the required skills and knowledge in a worker to make him/her fit and qualified for the job. Job analysis helps to understand job properly as well as to define job and decide qualifications and skills to perform a job.

Also known as employee specifications, a job specification is a written statement of educational qualifications, specific qualities, level of experience, physical, emotional, technical and communication skills required to perform a job, responsibilities involved in a job and other unusual sensory demands. It also includes general health, mental health, intelligence, aptitude, memory, judgment, leadership skills, emotional ability, adaptability, flexibility, values and ethics, manners and creativity, etc.

### Purpose of Job Specification

- ▶ Described on the basis of job description, job specification helps candidates analyze whether are eligible to apply for a particular job vacancy or not.
- ▶ It helps recruiting team of an organization understand what level of qualifications, qualities and set of characteristics should be present in a candidate to make him or her eligible for the job opening.
- ▶ Job Specification gives detailed information about any job including job responsibilities, desired technical and physical skills, conversational ability and much more.
- ▶ It helps in selecting the most appropriate candidate for a particular job.

### Primary contents of Job specification:

- Education
- Experience
- Training
- Physical efforts and skills
- Judgment and initiative
- Communication Skills
- Emotional characteristics
- Sensory needs (sight, smell, hearing)

### Four broad categories of Job specification:

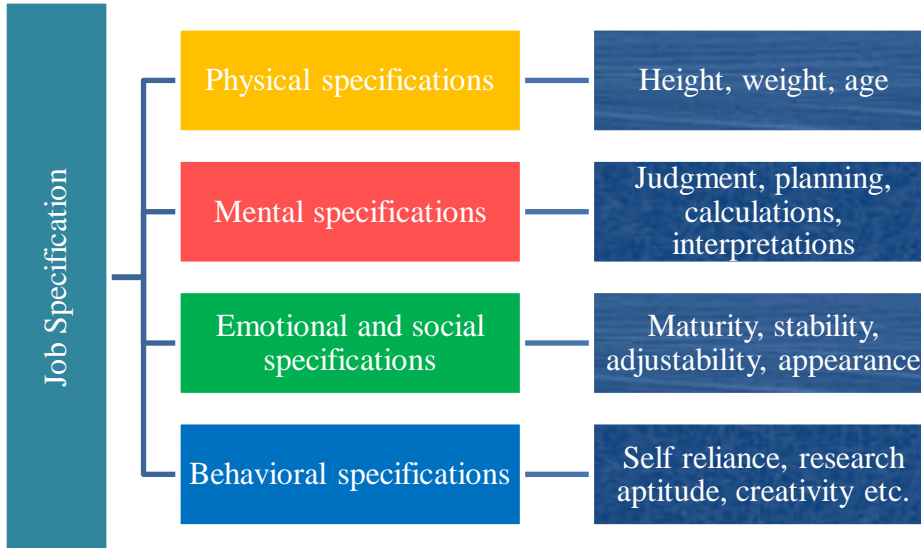


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## Uses:

1. **Human Resource Planning:** As it describes the job requirements in specific terms, it can be taken as a base for manpower planning.
2. **Pay Fixation:** Job analysis clearly states the complexities involved in the performance of the job. Moreover, it describes the required qualifications and skills to perform the job on the basis of which the worth of the job can be determined. This provides the base for determining the wage and salary to be given to the employees.
3. **Recruitment, Selection, Promotion, Transfer Decisions:** Job analysis states the necessary skills and qualifications for performing the job and thus, works as a base for hiring and selecting the employees. Moreover, criteria for promotion and transfer can be worked out on the basis of job analysis.
4. **Training and Development:** For designing the subject matter of the training and development programme job analysis provides the complete detail of the job content and job specification specifies the required qualities and skills for performing the job. On the basis of this information, training and development programmes are developed.
5. **Health and Safety Measures:** Job analysis is an exercise whereby hazards involved in the job are identified. Moreover, even it locates the area where there are the highest chances of accidents. This provides data for decision on health and safety measures as a part of proactive strategy.
6. **Performance Evaluation:** Performance evaluation is an exercise whereby actual performance is compared with the standard performance so as to keep a check on the progress of the employees. Standard performance criteria are developed on the basis of job description and job specification.





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<u>Difference between Job description and Job specification</u>	
Job description	Job specification
<ul style="list-style-type: none"><li>• Job description tells all about the tasks and responsibilities expected to be performed .</li><li>• Job description tells your what you must do when selected .</li><li>• The main purpose of job description to collect job-related data in order to advertise for a particular job.</li></ul>	<p>Job specification tells the level of experiences and skills that a candidate must have to be selected for the job.</p> <p>Job specification tells you what you must have to be selected for a job.</p> <p>It helps candidates analyze whether is are eligible to apply for a particular job vacancy or not.</p>

## Process:

1. **To Collect Primary Information:** Some primary and background information can be collected from different internal sources in the organization. Organization charts and job descriptions of other related job can be taken as a base as it gives some primary information regarding the basic nature of the job and the interrelation of the jobs in the organizational hierarchy.
2. **To Select Job to be analyzed:** All the jobs cannot be considered for analysis purpose. In the view of money and time constraints, only few jobs are selected for the purpose of job analysis.
3. **To Collect Data:** Job analysis data can be collected from three sources:
  - (i) Directly from the employees
  - (ii) From other employees under whose observation the job is performed
  - (iii) From the professional people who are appointed for the purpose of job analysis. They are known as job analysts.
4. **To Develop Job Description:** On the basis of the collected information, a statement describing the major characteristics & the job is developed which is known as job description.
5. **To Develop Job specification:** On the basis-of the job description developed in the previous stage, job specification is developed showing the specific qualifications, skills and knowledge required to perform the job. This is called Job Specification.

## RECRUITMENT

- HRP states the requirement of employees in terms of number and nature.





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- The next step is to find out from where the required employees can be availed and to work out the strategy for encouraging and attracting these prospective employees to the organization.
- Thus, recruitment is the process of searching the potential candidate for filling the organizational vacancies. Recruitment is the first step in building an organization's human capital.
- At a high level, the goals are to locate and hire the best candidates, on time, and on budget.

The sources of recruitment can be divided into two basic categories; Traditional and Modern. Again each one is divided into two types Internal and External.

(A) **Traditional Sources:** They are bifurcated into two parts:

- **Internal**
  - Present employees
  - Former/ Retired employees
  - Dependents
- **External**
  - Employment exchange
  - Advertisements
  - Campus recruitment
  - Professional firms or associations
  - Casual applicants
  - Computer data banks
  - Trade union

## 1. Internal Sources:

### 1. (i) Present Permanent Employees:

Generally, to fill higher level vacancies, first Preference is given to the present employees working on the permanent basis in the organization. This source is preferred for more than one reason: it is a motivating tool for the present employees; it is one way of keeping trade union satisfied it is a better source than the external source as present employees are familiar and well aware of the organization environment.

### 1.(ii) Present Temporary Employees:

Present employees working on the temporary basis can be given chance in case when their qualifications meet the requirements or when trade unions pressurize to do so. But with the help of this source, generally lower level positions are filled.

## 2. Retired Employees:



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Lack of work is the main reason due to which employees lose the job in majority of the cases. Organization can always reconsider those employees who have already served the organization in the past if their qualifications match the requirements of the new openings.

### 3. Dependents of Present, Deceased, Disabled or Retired Employees:

At times, an opportunity is given to the dependents of the present, deceased, retired or disabled employees in the organization. This is how an organization can show its commitment towards not only the employees but their family members also.

### 2. External Sources:

#### 1. Private Employment Exchanges:

There are some private employment consulting firms doing the work of recruitment on behalf of the client organization. Line managers of these organizations do not have to worry for this function as it is performed by the professional firms in return of some fees.

#### 2. Public Employment Exchanges:

Public employment exchanges work as intermediaries between the job seekers and job providers. According to the provisions of the Employment Exchange Act, 1959, some vacancies in all the organizations have to be filled through the public employment exchanges.

### 3. Advertisements:

This is the most widely used method of seeking recruits because of the biggest advantage of its wide reach. Basically there are two types of employment advertisements: (i) want ads (ii) blind ads.

Want ads are very familiar form of advertisements. These ads describe the job and its benefits, identify the employer and explain how to apply. Newspaper is the most common medium of advertising.

Ads which do not identify the employer are known as blind ads. Potential candidates are directed to reply to a post box number or a consulting firm retained by the recruiting organization.

### 4. Campus Recruitment:

From different educational institutions like schools, colleges and universities providing education in different fields, inexperienced candidates can be recruited as well as from training institutions, trained candidates can be recruited.

### 5. Professional firms:

Some organizations specialize in providing mediating service to the organizations requiring employees and the candidates requiring the jobs. They help particularly in filling the executive posts.

### 6. Casual Applicants:



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Some candidates apply on their own in the organization. Without organization giving any advertisement for their job vacancies. Such applicants can be considered for the lower level or temporary jobs.

## 7. Computer Data Banks:

Resumes of different candidates can be collected from different sources and this data can be stored in computer and can be used as and when needed.

## 8. Trade Union:

As trade union has good contacts with the management interested candidates remain in touch with the trade union, thus, trade union would have information regarding prospective employees and it can be used as a source of recruitment.

## 9. Other Organizations:

At times, employees of the organizations working in the same field can be attracted to fill executive positions.

## (B) Modern Sources:

- **Internal**
  - Employee referrals
- **External**
  - Walk – ins
  - Consultants
  - Employees leasing firms
  - Alliances for human resource sharing
  - HR supply firms
  - E – recruitment

### 1. Internal Source – employee referrals:

The most widely used internal source of recruitment is Employees Referrals. Present employees can work as an intermediary, between their relatives and friends. They would be well aware of the qualifications and talents of their relatives and friends and on the other hand, even they would be familiar with the culture of the organization and nature of the work for which post is vacant. This source is very effective and less costly.

### 2. External Sources:

#### 1. Walk in:



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When the organization does not have time to conduct elaborate recruitment programme, an advertisement can; be put in any media whereby candidates are asked to remain present for the selection on a specified date, at the specified time and at the specified place.

## 2. Search Consultants:

Some companies take the help from the professional organizations in searching the suitable candidates for filling senior positions. These professional firms have a record of people working on such high positions. In case of need, they use these records and help the companies which are in need of employees. They are even known as head hunters, or raiders.

## 3. Consult-in:

Some companies put an open offer to the job seekers to approach them on their own in case of need. Such candidate's are considered according to the requirement.

## 4. Employees leasing Firms:

There are many Professional organizations which maintain the stock of the prospective employees. They make them available to the employers in case of requirement. These leasing firms earn commission for their work.

## 5. Alliances for Human Resource Sharing:

Companies can form alliances whereby they share the available human resources. Generally in such kind, of agreement, companies with the extra employees can make their employees available to the companies which are in need of employees.

## 6. HR Supply Firms:

Some organizations employ the human resources for providing them to others in case of their requirement. The pool of human resource is developed to make them available to other needy organizations. These are known as outsourcing firms.

## 7. E-Recruitment:

Internet can be used as a source of recruitment in today's technologically advanced world. Organizations can put their human resource requirements on the Internet in the form of advertisement. Interested candidates can respond through Internet. On the other hand, job seekers put their resumes on Internet which can be used by organizations according to the requirement.

The **E-Recruitment**, also called as **Online Recruitment**, is the process of hiring the potential candidates for the vacant job positions, using the electronic resources, particularly the internet.



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E-Recruitment includes the entire process of finding the prospective candidates, assessing, interviewing and hiring them, as per the job requirement. Through this, the recruitment is done more effectively and efficiently. Generally, the job vacancies are advertised on the World Wide Web (www), where the applicants attach their CV or resume, to get recognized by the potential recruiters or the employers.

## Methods of E-recruitment:

- Company's own website
- Ads on other sites

Monster.com

timesjobs.com

Naukri.com

- Professional organizations

Society for HRM

- Private employment agencies (specific sector)

## Services provided by E – recruiters/ E – Recruitment Agencies

- Online test delivery with minimal manual efforts
- High quality assessment content for various IT systems
- Time specific testing environment
- Comprehensive organization wide reports
- Deliver questions in different order to assess each candidate by creating randomized tests
- Off premise test via internet

## Benefits of E – recruitment

- Low cost per candidate, as compared to the physical recruitment process.
- Wide geographical coverage, i.e. the candidates can be hired from any part of the world.
- Beneficial for both the employer and the job seeker, the corporations can find the prospective candidates through their CVs attached to world wide web, and similarly, the candidates can search the employer through their job vacancy advertisement posted on the internet.
- Less time required in hiring the potential candidate for the firm.
- Right people for the right job can be easily found through E-Recruitment, by matching the candidate's CVs with the job profile.
- The recruitment process becomes more efficient and easy to record details of the applicant.

## Skills that recruiters search for:

- Ability to work in a team



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- Analytical and problem solving skills
- Communications and other soft skills
- Creativity and resourcefulness
- Leadership potential
- General management skills
- Entrepreneurial skills

## SELECTION

- Recruitment prepares the base for selection. Recruitment function identifies the sources of human resources and encourages prospective employees to apply for the vacant positions in the organization.
- Selection is the process whereby the qualifications and skills of the applicants are matched with the job specifications so as to select the right candidates for the right job.
- Selection is the process in which candidates for employment are divided into two classes- **“those who are to be offered employment & those who are not.”**
- **Selection** is the process of **selecting** a qualified person who can successfully do a job and deliver valuable contributions to the organization. A **selection** system should depend on job analysis. This ensures that the **selection** criteria are job related and will provide meaningful organizational value.
- The requirements for a selection system are knowledge, skills, abilities, and other characteristics (KSAOs). Personnel-selection systems employ evidence-based practices to determine the most qualified candidates, which can include both new candidates and individuals within the organization.

## Process of Selection:

The selection procedure covers following major stages:

- Preliminary interview or screening
- Application form
- Selection tests
- Interviews
- Medical examinations
- Reference checks
- Final approval and appointment



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## 1. Preliminary Interview or screening:

When the organization gets large number of applications, it is advisable to conduct preliminary interview so that the candidates not fulfilling the primary criteria can be eliminated at the outset only. It is a sorting process wherein the candidates are given some basic information on the nature of the job to be performed and the nature of the organization. At the same time, organization tries to collect some primary information on the qualifications, experience, expected salary, etc from the prospective candidates. The main purpose of this interview is to reject the candidates who do not satisfy the minimum requirement for getting selected in the organization.

## 2. Application Form:

An application form or an application blank is a tool with the help of which the information required for making selection decision is collected from the candidates. Application form can be very long and detailed or it can be short and precise. Mainly it contains following Information:

- (i) **Personal information:** Name, Address, Date and Place of Birth, Age, Gender, Nationality, Height and Weight, Marital Status, etc.
- (ii) **Educational achievement:** Degrees obtained, Subjects selected, Training undergone, other courses completed, etc.
- (iii) **Expected and Present salary.**
- (iv) **Experience:** Number of previous jobs, duties performed and salary offered in each case, etc.
- (v) **Other Information:**
  - a. Achievements in sports and extra-curricular activities, hobbies, memberships in professional institutions, etc.
  - b. The data provided in the application form serves as a base for evaluating the candidate and for checking the possibility of his/her selection for the job concerned.

## 3. Tests:

Tests are very important instruments for doing comparative evaluation of candidates on the basis of their behavior and attitudes. It works as a tool to match the requirements of the job and the characteristics of the candidates, necessary input for taking selection decision. Selection tests can be grouped into following categories:

- a. **Aptitude Tests:** These tests measure the ability of the candidate to acquire new skills and to learn new job if adequate training is given.





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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- b. Achievement Tests:** When the organization wants to employ experienced candidate, these tests are taken with the help of which the accomplishments of the candidates is measured.
- c. Interest Tests:** These tests are conducted to know the likes and dislikes of the candidates so far as the job, work and hobbies, recreational activities are concerned.
- d. Situational Tests:** These tests measure the ability of the candidates to cope up and work under different critical situations.
- e. Personality Tests:** These are the tests that measure different personality traits like maturity, values and principles, emotional stability, etc

#### 4. Interview:

Interview is a tool which helps the employer to gather some important information on the basis of the Candidates oral responses to the oral inquiries made by the interviewers. It is a two-way exchange of information wherein the interviewer tries to know about the candidate and the applicant tries to know the employer. No selection procedure gets complete without interview.

#### Basically interviews are following types:

- (i) **Structured Interviews:** Here, the questions as well as acceptable responses are pre-decided
- (ii) **Unstructured Interviews:** Here, in the absence of the pre fixed format, questions are asked as they come in mind while taking with the candidate.
- (iii) **Panel interviews:** These are interviews conducted by more than one expert so that an all-round evaluation of the candidate is done and also helps in reducing personal biases and errors in selection.
- (iv) **Stress interviews:** Most organizations these days conduct the interview in a manner to test the ability of an individual in a stressful condition.
- (v) **In depth or action interview:** This interview is conducted only for selecting a person for top level jobs. The interview is an in depth discussion over various issues and can continue for two to three days.
- (vi) **Discussion interview:** The interview is in the form of a group discussion among the prospective candidates and the interviewer observe the discussion and identifies the candidate with required qualities based on the interaction in the discussion.

#### 5. Medical Examination:

Physical examination is meant for judging the physical fitness of the candidates. Medical examination tells whether the PI candidate possesses the required physical capacity according to the job requirements or not. It provides base for the selective placement of the candidate on the basis of the identified deficiencies through medical examination.



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Ph. No–(0281)2471645

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Nr. Amrapali Railway Crossing  
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## Physical examination serves many purposes:

- (I) Physical fitness of the candidate can be judged.
- (II) It reveals the existing disabilities of the applicants at the time of getting job in the company and even works as a future reference.
- (III) Candidates having contagious diseases can be identified and rejected.
- (IV) Candidates who are otherwise suitable for the job but physically handicapped can be put to specific job.

## 6.Reference Checks:

Applicants are asked to give references of two or three well- known persons who know the candidate well. Previous employer can give reference for his past employee. On the basis of the information provided by these people, judgment can be derived regarding the potential performance of the candidate. Opinion given by the referee is generally not considered very reliable as the opinion given is rarely unfavorable, then also reference check is considered very important stage in the selection process.

## 7.Final Approval:

At the end of the selection procedure, human resource department gives its recommendation on the selection of the candidate. Final decision is left on the concerned department where the candidate is to be put on the job. If approved, appointment letter is issued to the candidate wherein the designation, salary grade and terms & conditions of the employment are mentioned.

## DIFFERENCE BETWEEN RECRUITMENT AND SELECTION:

Basis	Recruitment	Selection
Meaning	It is an activity of establishing contact between employers and applicants.	It is a process of picking up more competent and suitable employees.
Objective	It encourages large number of Candidates for a job.	It attempts at rejecting unsuitable candidates.
Process	It is a simple process.	It is a complicated process.
Hurdles	The candidates have not to cross over many hurdles.	Many hurdles have to be crossed.



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Approach	It is a positive approach.	It is a negative approach.
Sequence	It proceeds selection.	It follows recruitment.
Economy	It is an economical method.	It is an expensive method.
Time Consuming	Less time is required.	More time is required.

## PLACEMENT:

In very simple words placement means sending the newly employed person to some department for work. It also implies assigning a specific rank and responsibility to an individual. Matching the requirements of the job with the qualifications of a candidate is the essence of placement. After hiring an employee, he must be placed in the right job.

According to Pigors and Myers “**Placement is the determination of the job to which an accepted candidate is to be assigned and his assignment to that job. It is a matching of what the supervisor has reason to think he can do with the job demands. It is a matching of what he imposes (in strain, working conditions etc.) and what he offers (in the form of payroll, companionship with others, promotional possibilities etc.).**”

### **Steps in Placement:**

- Collect details about the employees
- Construct his/ her profile
- Match individual profile with sub group profile
- Compare sub group profile to job family profiles
- Fit employee profile with job family profile

### **Placement problems:**

- ▶ If the expectations of the employees differ from the job offerings, problems arise
- ▶ There can be mismatch between job and employee if employee abilities and skills fall short of the job requirements
- ▶ Mismatch between the job and employee could be the result of change in job description and job specification brought about by change in technology



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- ▶ Some strategic developments like merger and acquisition, downsizing etc. brings changes in organization structure and thereby changes in the jobs.
- ▶ At times, social and psychological factors involved in team work result into mismatch between job and employee

## INDUCTION:

- Induction is the last stage in the employment process. It is one the important functions to be performed in the HR department of any organization.
- Induction means introduction of a new employee to the job and the organization. It is the process of receiving and welcoming an employee when he first joins a company and giving him the basic information he needs to settle down quickly and happily and start work.
- It is a welcoming process to make him feel at home and generate in him a feeling of belongingness to the organization. In the process of induction the new comer is explained his duties and responsibilities, company rules, policies and regulations so as to make him familiar to the organization.
- Induction is a function whereby a new employee is made familiar with organization and other employees with whom one has to work. When a person is put to new job, as a probationer, one would feel insecure and uncomfortable.
- Therefore, induction is necessary to make one feel comfortable and familiar to the new people; new job and new environment. Induction is a welcoming process whereby an employee is received when he/she joins the company. Different methods are used for the purpose of induction: seminar, lecture, presentation etc.

## **Objectives of Induction**

- ▶ Removing fear of what is unknown to the employee in the job and about the organization, terms and conditions of employment
- ▶ Creating a good impression and developing a sense of pride in the new employee
- ▶ Providing information about rules and regulations, job requirements to make a person feel confident about his/ her capabilities.

## **Process:**

1. A new employee reports to the head of the department the specified date and place for duty.
2. The head of the department receives and welcomes the e employee in the department.
3. Head of department introduces the new employee to the branch head.
4. Branch head introduces new employee to other employees.
5. Departmental head gives information regarding the department and the main function of the department.
6. Supervisor gives information on the work to be done, material and machines to be used, etc.
7. Information is given on duties, responsibilities, authority facilities, etc.



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8. Clarifications are given to the employee by the supervisor, if asked for.

## Significance:

1. It arouses the interest of the new employee in the job.
2. It gives primary information regarding working arrangements.
3. It puts the new employee at comfort and ease in the organization.
4. It makes the new employee aware of the importance of his/her new job.
5. It helps in creating the feeling of security.
6. It provides information on major facilities available in the company.
7. It provides clarity on all important aspects which are of interest to employee so that employee can start the work with all clarity in mind.



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3- Vaishalinagar  
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Nr. Amrapali Railway Crossing  
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Ph.No–(0281)2440478, 2472590

## UNIT – 3

### TRAINING & DEVELOPMENT

#### INTRODUCTION:

- Training and Development is one of the main functions of the human resource management department. Training refers to a systematic setup where employees are instructed and taught matters of technical knowledge related to their jobs.
- It focuses on teaching employees how to use particular machines or how to do specific tasks to increase efficiency.
- Whereas, Development refers to the overall holistic and educational growth and maturity of people in managerial positions. The process of development is in relation to insights, attitudes, adaptability, leadership and human relations.
- Training and development signifies imparting of specific skills and knowledge to an employee. The biggest concern in any organisation is to see to it that employees perform to the best of their ability.
- Ability to perform is a function of employee's attitude and employee's skills and knowledge.
- Deficiency in employee's performance determines the requirement of training and development.
- The calculation of this deficiency is done as under:

**Standard/ ideal performance - actual performance = deficiency in employees performance (need for training)**

#### Training, Education & Development

- **There are three terms having close meaning: Training, education and development.**
- Training is imparting specific skills.
- Education is learning in classrooms mainly in theoretical context.
- Development refers to learning opportunities designed to help employees expand and broaden their thinking as well as perspective and thus leading to their growth and development.

#### Importance of Training

##### **Benefits to the Organization:**

- It develops employee's attitude towards profit orientation thus leading to improved profitability
- It expands job related knowledge and enhances skills
- It boosts morale of the employees in the organisation
- It becomes helpful in improving relationship between the superior and subordinates as well as overall relationship between labour and management
- It helps in creating and maintaining better corporate image



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- An understanding on organisational objectives improves
- Execution of organisational policies becomes smooth
- It expands decision making and problem solving skills of the organisational members
- It facilitates internal recruitment through promotions
- As employee efficiency increases, cost in many areas like production, administration etc. reduces
- Productivity and Quality of work improves
- It develops internal consultants so cost of outside consultancy reduces
- It develops a sense of responsibility among organisational members
- It helps in overcoming the resistance to change as readiness to accept the change increases
- It facilitates conflict management thus prevents the occurrence of stress and tension

## **Benefits to the individual:**

- It improves decision making and problem solving skills
- It internalizes motivational variables of recognition, achievement, growth and responsibility
- It strengthens the person's ability to handle stress, frustration and conflict
- It encourages self development
- It helps a person to achieve personal goals in the process and improve interactive skills
- It gives a feeling of achievement and improves job satisfaction
- It develops confidence and helps in eliminating fear in initiating new tasks

## **Benefits in terms of improving human relations, intra – group and inter – group relations:**

- It improves interpersonal skills
- It results into improving communication between individuals and groups
- It helps increasing group cohesiveness
- It develops a good environment for learning, growth and development
- It contributes in making an organisation a better place to work and live for the employees

## **NEEDS OF TRAINING AND DEVELOPMENT :**

### **Identifying Training & Development Needs**

- Need Assessment happens at two levels:
  - 1. Individual Level
  - 2. Group Level

### **Need Assessment – Individual Level**

- Gap between employee's actual performance and desired performance
- If the reason for this deficiency is shortage of skills and abilities, training is needed





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- There are certain other initiatives that can be taken along with training. These can be change of change of a job practice, transfer or termination
- In view of the changing environment, need assessment should also consider the requirement of new skills in future. As technology changes, new set of skills are required. Training becomes necessary to make an employee ready to face the challenges of new tasks so as to help him or her in growing on career path.
- Another reason for training could be possible job transfer as it may require new skills. But in most cases only an orientation is required instead of an elaborate training
- These days, face of industry is changing due to foreign competition, technology and forces of demand and supply and this necessitates retraining to ensure continued employment for many individuals
- Some methods that are used for individual analysis are
  - Interviews
  - Questionnaires
  - Performance appraisal
  - Training progress
  - Work sampling
  - Attitude survey
  - Rating scale

## Need Assessment – Group Level

- Change in organisational strategy creates the need for training for group of employees
- For example, an introduction of a new product create need for training of production workers, sales personnel as well as a service people
- Moreover, low morale and motivation, high accident or scrap rates etc. are the possible outcomes of poorly trained workforce
- When such problems are identified training becomes a solution
- Commonly used methods for need assessment at group and organisational level are organisational goals and objectives, MBO, quality circles, efficiency indices, personnel/skill inventory, exit interviews, customer satisfaction data and consideration of current and estimated change

## Issues in Need Assessment

- **Organizational Support**

Highest amount of cooperation occurs when need assessment is designed and carried over with the support of the organization

- **Organizational Analysis**

Examination of organizational goals and the trends that are likely to affect these goals is the next step in the need assessment so that gap can be filled through training



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- **Task and KSA Analysis**

Identifying the task on each job and the required Knowledge, Skills and Abilities (KSA) required to perform these tasks and this can be achieved through training programs

- **Individual Analysis**

Determining KSAs already learnt by trainee so as to prevent wastage of time in repeating what is known to the employee. Now those employees who need to undergo separate training are identified

### **Advantages of Need Assessment**

- Trainers can be provided with the necessary information on the needs of the trainees
- Trainers can prepare the training material keeping in view the needs of the trainee
- Accountability of the training department becomes clear and even it can be clearly linked to other HR activities
- This facilitates the work of selling the training programs to line managers

### **Results of absence of training need assessment**

- Increasing employee turnover
- Limits on business development
- Increase in overtime working
- Higher rates of pay and overtime premiums
- Increase in recruitment cost
- Extra retention cost like part time working, job sharing, shift working etc.
- Requirement for job redesign and revision of job specifications
- Increase in training costs

### **ADIME MODEL FOR DESIGNING TRAINING PROGRAMME:**

#### **Framework for HRD Process – ‘ADIME’ Model for designing training programme**

- HRD efforts should use the following four phases/ stages:
  - Need **A**ssessment {A}
  - **D**esigning the Training Program {D}
  - **I**mplementing Training Program {Im}
  - **E**valuation {E}



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NEED ASSESSMENT	DESIGNING TRAINING PROGRAM	IMPLEMENTING TRAINING PROGRAM	EVALUATION
Industry level analysis	Determining training objectives	Clean and ventilated venue for training	Objective/ Need for evaluation
Job level analysis	Identifying participants	Audio visual requirements	Principles of evaluation
Organizational level analysis	Identifying trainer	Ambiance for training place	Levels of evaluation
	Determining training budget	Presence of trainer and trainees	Techniques of evaluation
	Designing training content and material	Conducting the session effectively	
	Identifying types and methods of training		
	Developing reference material for training		
	Scheduling the training program		

## DESIGNING TRAINING PROGRAMS:

- **Identification of participants/ trainees:** The selection of the trainees is done on several bases like self nomination, recommendations of supervisors or by the HR department. It is always considered to be good to have two or more target audiences. When different internally connected target audience are brought together, group processes like decision making and problem solving are facilitated.
- **Identification of trainers:** Several people can conduct training program. These are the immediate supervisors, coworkers, members of the HR staff, specialist in other parts of the company, external Consultants, industry associations and faculty members at University. The important factor on which the



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selection of the trainers depend is the style of skills to be taught. Usually the organisations have separate training department whose staff conduct training programs.

- **Determining method of training:** Various methods are used to train employees. These methods can be categorised into two: On the job training methods and off the job training methods. On the job training methods are applicable in workplace while the employee is actually working where as off the job methods are used away from the workplace.
- **Deciding the level of training:** Basically there are three levels at which training inputs are taught: At first level, basic and fundamental knowledge must be acquired by the employee. At the second level, the aim is to obtain the ability to perform in a specific skill area. The objective of the highest level is improving operational efficiency.
- **Determining learning principles:** Incorporation of some learning principles makes the training and development programs effective. The basic requisite to make training program effective is employee motivation. Individual differences in terms of learning ability must be recognised while organising training programs. Reinforcement is another important Principle of Learning. Feedback is a necessary condition for learning. Goal setting is one more important principle along with the schedule of learning. Meaningful learning material is also important and what is learnt in training must be transferred to the job.
- **Determining the place to conduct training:** Final consideration in designing training program is determining place for conducting the training. At the job itself, on site but not the job and off the site. The selection depends on the nature of skills to be imparted.

## TYPES OF TRAINING:

### ON – THE – JOB TRAINING

- On-the-job training, also known as OJT, is a hands-on method of teaching the skills, knowledge, and competencies needed for employees to perform a specific job within the workplace. Employees learn in an environment where they will need to practice the knowledge and skills obtained during their training.
- On-the-job training uses the existing workplace tools, machines, documents, equipment, and knowledge to teach an employee how to effectively do their job. Consequently, no stand-ins exist that will require an employee to make the training transfer to the workplace.

### **Advantages of On – the – job Training**

- Quick Learning



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- There is no line and staff conflict
- Economical
- At workstation
- Multi – skill
- Quick productivity
- Simplicity

## **Disadvantages of On – the – job training**

- Low productivity
- Errors in production
- Costly
- Disturbance
- Possibility of accidents

## **OFF – THE – JOB TRAINING**

- Off-the-job training is conducted in a location specifically designated for training. It may be near the workplace or away from work, at a special training center or a resort
- Conducting the training away from the workplace minimize distractions and allows trainees to devote their full attention to the material being taught-
- However, off-the-job training programs may not provide as much transfer of training to the actual job as do on-the-job programs.
- Methods include lectures, conferences, seminars, case study, role plays, business and management games etc.

## **Advantages of Off – the – job Training**

- No error in production
- Economy
- Large people
- Less time of training
- Free of production process
- High productivity

## **Disadvantages of Off – the – job Training**

- Outside workstation
- Not effective
- Lack of feedback
- No production



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- Expensive

## METHODS OF TRAINING

### ON THE JOB

- Coaching method
- Job rotation
- Understudy
- Multiple management
- Apprenticeship training

### OFF THE JOB

- Case study
- Incident method
- Role playing
- In basket method
- Business game
- Sensitivity training
- Simulation
- Conferences
- Lectures
- AV, Programmed instructions

### **ON-THE-JOB TECHNIQUES:**

An attempt is made to improve on the job behavior by imparting training and education while doing the job. As no separate time is spared for the purpose, it proves time-saving and less costly. But at the same time, there are chances that it might not give effective results as learning takes place under the pressure of routine regular job. Some Popular on-the-job techniques are explained as under:

#### **1.The Coaching Method:**

- Coaching method serves dual purpose of increasing operative efficiency as well as improving thinking abilities of the managers.
- The main duty of a coach is to instruct, to direct and to help. The coach decides broad goals in consultation with the trainee and it is left on trainee how to work on achieving the agreed goals.
- The coach gives suggestions if needed. The coach does periodic review of the trainee's, progress and changes are suggested if required to correct the behavior of the trainee.
- The objective of this method is not only to improve the performance of the trainee but it even tries to ensure future development and progress of the trainee.



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## For effective Coaching

- Coach should help trainee when demanded or needed
- Coach should communicate appropriately with trainees and even try to stimulate (□□□□□□□□) them
- Coach should give space to trainees to feel the experience of doing job without being dominant on them and not making trainees dependent on coach all the time

## **Advantages:**

1. The trainee learns while doing the job. It is learning by doing.
2. Continuous performance evaluation is a part of coaching method.
3. It is a part of regular work of each executive. Thus, separate centralized set-up is not required.

## **Limitations:**

1. The success of the method depends on the teaching ability of a coach. Coach's inefficiency at teaching can become the reason for the failure of this method.
2. As training takes place in the regular working environment during the regular working hours, it might not produce desired results as the benefit of specific training atmosphere cannot be availed.
3. Here, it is the sole decision of the coach what to teach to the subordinates. Thus; subordinates are taught the work methods and work styles of the coach even if they are defective.
4. Trainee's progress would remain confined to the abilities of the coach.

## **2. Job Rotation:**

- Job rotation is a method aimed at broadening the knowledge and skills of the trainees. Under this method trainees are rotated from one job to another according to the pre-determined plan so that trainees can have an exposure to different types of jobs.
- Generally, job rotation method is used to familiarize a person with the overall functioning of the particular department or division in which one is to be promoted as a manager to head the department or division.
- Thus, job rotation prepares a trainee to perform different types of jobs within a particular broad job category.

## **Advantages:**

1. Job rotation facilitates creativity in the organization as people are rotated among jobs, they would bring new ideas for performing tasks. This is not very much possible when employees keep on doing the same assigned work.
2. As employees get chance of doing different jobs, boredom and monotony can be reduced.
3. Coordination among departments can be ensured easily as people are moved from one department to another on regular basis.
4. When an employee is promoted, one's former colleagues would become subordinates. Thus, acceptance becomes easier if the organization has the policy of job rotation in practice.





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5. Overall managerial efficiency gets strengthened in the organization as employee gets a chance of showing talent at different places.
6. Comparison of employees on the basis of performance gets easier as both can be given opportunity to work on the same position as a part of job rotation policy.
7. Employees can develop overall balanced attitude towards organizational goal as they become aware of other tasks and challenges involved in all the tasks.
8. As each employee gets a chance to show one's worth in a variety of jobs, it leads to best utilization of employees' talents.
9. It broadens the viewpoint of employees as job rotation develops generalists, not specialists.

### Limitations:

1. It might lead to decrease in the efficiency in the organization. As employee has to make an attempt to learn new job and to adjust to the new demands at regular interval. It leads to errors and disruption in organizational operation.
2. Frequent movements among the jobs and resulting transfers might disturb the family and personal life of employees.
3. An employee would always try to bring in new changes when put on new job but at times hasty changes lead to costly experiments.
4. It takes time to adjust to new superior and subordinates at frequent intervals.
5. Employees wanting to become the master of their specialized area would get discouraged.
6. It might result into class distinctions among employees, employees who are considered eligible for rotation and the ones who are left behind.
7. It develops the feeling of envy and hostility among employees.

### Suggestions for effective job rotation:

1. Employees who are to be rotated should be explained the new work properly.
2. Job rotation should be taken as a learning experience by the employees.
3. Employees should identify themselves with the new assignment so that they can assume the responsibility on new job fully and try to ensure job improvement.

### 3. Understudy:

- Understudy is a person who is selected to undergo training under the superior on whose position he is to be promoted in future.
- The trainee is prepared for assuming the full duties and responsibilities of the position currently held by his superior.
- Thus, a fully trained person is made ready to take charge of the position which may fall vacant temporarily because of illness or long absence or permanently as a result of transfer, promotion or retirement.



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- After selecting an understudy from many employees in the department, one is put for training wherein the superior makes him understand what the job is and how can it be done.
- Understudy tries to learn how to solve the difficult problems involved in the job.
- Moreover, one learns decision making as superior allows the understudy to take part in the discussion and deliberations of routine operating problems as well as long term critical problems.
- Superior tries to give the understudy the feeling of doing the job by assigning the project which is similar to the duty that he has to assume in future.

## Advantages:

1. The superior's work is shared by the trainee thus relieving him from heavy work burden.
2. Trainee's enthusiasm and interest would be high as one would be assuming the charge superior's position in future.
3. With the help of this method, people can be trained to take higher responsibility in less time people as here learning by doing is ensured.
4. Here, trainee can learn the job from different viewpoints as one is put under direct guidance of the person doing the job at present. It ensures learning the job in its totality.
5. As trainee learns how to solve all probable problems, chances of committing costly mistakes in future can be avoided.
6. This method develops effective second line resulting into continuity of managerial services and facilities in the organization.

## Limitations:

1. Selection of an understudy makes it clear to all the employees in the department that who is going to be the next occupant of a managerial position. This discourages other employees.
2. As selection of understudy is done by the superior, there are all chances of favoritism. This leads to perpetuation of the same management styles and policies.
3. If the superior is extra dominant, understudy's independence is hindered.
4. Other employees in the department might not accept a person as a boss in future and might not cooperate.

## 4. Multiple Management:

This technique is also known as participation in deliberations of the junior board as here juniors are put in boards or committees by the chief executive. Here, juniors undergoing training are required to take part and contribute in the discussions of the boards or committees, real life problems are discussed and analyzed from different angles, different possible solutions are debated and finally decisions are taken at the end of the discussion and deliberations.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

The boards or the committees in which juniors are put can be temporary/ ad hoc or permanent. In case of ad hoc committees, a particular temporary assignment is taken on hand involving some problems. Alternative solutions are derived in the discussion and deliberation is done on different views. At the end, solution is derived and recommendations are given on the basis of that.

## Advantages:

1. Here, juniors get an opportunity to involve themselves in solving organizational problems whereby they learn by watching others.
2. With the help of this method, juniors can gain knowledge and understanding on different issues related to the working of the organization.
3. It is relatively less costly method of development.
4. Juniors learn how to work in teams and how to take group decisions.
5. Juniors learn how to respect others' opinion and views.
6. People having executive talents can be identified. With the help of board rating system; Multiple views are collected on each individual's managerial talent.
7. Many employees can be given training within a shorter period of time.
8. It contributes towards the development of better human relation climate in the organization.

## Disadvantages:

1. It is not tailor-made approach in the sense that it does not focus on the specific training requirements of the employees.
2. It is not useful for all level managers as it suits to only middle and higher level managers.
3. The discussions and deliberations do not serve the purpose of training as often it gets off track in the absence of commitment of the members to reach to concrete conclusions.

## 5.Apprenticeship Training:

- A formal occupational training program combining on – the – job training with related instructions that enables workers to master the practical and technical skills required for skilled occupation.
- Generally this training is given to technical staff. Ex. Mechanics, electricians, craftsman, welders etc. They work under the experts of each field for a longer period.

## Advantages:

- Earn while learning
- Economical as it does not require special settings
- Mistakes can be corrected immediately
- Increases confidence and improved productivity
- Maximum learning through practice and observation



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## Disadvantages:

- Less wages to apprentice
- Trainees may damage machines or waste resources while learning
- Work may lag and suffer on part of trainer
- Does not permit any specific attention

## OFF-THE JOB TECHNIQUES:

### 1. The Case Study:

- A case is an objective description of the business situation happened in real-life.
- Trainees are given cases for discussion wherein they have to identify apparent and hidden problems for which the solutions are to be suggested on the basis of analysis.
- The executive only would know the actual decision taken in the subject case which he would disclose at the end of the session.
- This would be compared with the different solutions suggested by the group. In short, in case study method, real business situation is described in a comprehensive manner in form of a case.
- The trainees have to separate the important facts from the trivial items, analyze important facts, find out the different probable solutions, and suggest the best one on the basis of comparative analysis.

## Advantages:

1. It improves participants' decision making skills and problem solving abilities.
2. It sharpens the analytical and judgmental abilities of the participants.
3. Participants learn how to arrive at generalizations in spite of the fact that there is no one solution to the problem.
4. Trainees can have interesting learning experience as generally cases are based on real life situations.
5. Trainees are made aware of the problems and uncertainties faced in real practical situations by managers.

## Disadvantages:

1. Case development and preparation is a difficult task. Moreover, it is time-consuming and costly exercise. In the view of its uncertain result, at times it is not worth the expenditure.
2. If cases are taken from books then such theoretical exercise might not serve the purpose of real learning.
3. At times the cases become the permanent precedents in the minds of trainees. They would use them aimlessly.

## Essentials for the effective use of this method are as follows:

1. The case should be written in such a manner that it represents the issues involved objectively. It should not cover the opinions and comments of the case writer.



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
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Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

2. It should sufficiently provide the background information the organization in terms of its history and other related facts and figures so that the learners can understand the context of the event narrated.
3. Learners should have sufficient clarity on required management concepts.
4. There should be full representation of the case situation. Presentation through role play or with the help of film or television can be thought of.
5. The case should be based on the factual and first hand information.

## 2. Incident Method:

Paul and Faith Pigors are the pioneers of this method. Here, each; employee has to ensure one's own development while interacting with the group.

### This method focuses on the development of three things:

1. Intellectual ability- thinking ability and rationality,
2. Practical judgment- adjusting intellectual decisions for meeting practical requirements, and
3. Social awareness- taking note of the feelings of those who are going to get affected by the decision taken.

Incidents are developed on the basis of the real situations which have taken place in different organizations. Each employee is asked to study the incident and at the end of the study, each one has to take short term decisions assuming oneself at the place of the person who had to cope with the incident when actually it would have taken place, Later, the group meets for the discussion wherein all the group members interact with one another mainly on 'what', 'where', 'when', 'how' and 'why' of the situation in which the incident happened. Each member contributes on these important aspects. At the end, most important items for decision making are identified on the basis of the data collected from each group member.

## 3. Role Playing:

- This method aims at developing human relation skills.
- Here, participants are put to realistic behaviour in imaginary situation so that they can have an insight in to their own behaviour and they can understand the effect of their behaviour on others which develops their human relations skills.
- According to Norman Major, "A role-playing experience soon demonstrates the gap between Thinking' and 'doing' the idea of role-playing involves action, doing and practice."
- Here, trainees are given specific roles that they do in case of stage play or drama. They are supposed to interact with each other assuming different roles.
- The role players are the roles to be played by them but dialogues are not provided. At times, the play is tape-recorded and the trainee can be given an opportunity to observe and study his or her own performance.



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**Generally, role-playing is done on the situations involving interaction between employees and employer such as:**

1. Discussion on the grievance
2. Employment interview
3. Post-appraisal interview
4. Salesman making a presentation to a customer, etc.

### **Advantages:**

1. It proves interesting for the trainees. Thus, it leads to higher involvement of the trainees.
2. Result can be known immediately.
3. This method is based on 'learning by doing'.
4. Emphasis is given on human interactions and sensitivity.
5. It develops human relations and interactional skills of the employees.
6. It is a blend of theoretical and practical learning as it creates the live situation in the classroom.
7. For bringing desired attitudinal and behavioral changes, this method is very useful.

**Following are the essential points to be kept in mind for ensuring effective use of this method:**

1. Trainer has to be an effective coach.
2. Trainer should set the standard criteria for desired behaviour.
3. Desired behaviour should be reinforced to achieve the objectives of the training programme.

### **4. In-Basket Method:**

In this method, trainees are put in teams and each team is provided with the file of correspondence related to a particular functional area of management. Each member of the team has to study the details and suggestions are to be given on the situation. At the end, suggestions and observations of all the team members are compared and some common conclusions are derived on different functional areas.

### **Advantages:**

1. In this method, decisions are taken quickly and feedback decisions can be given immediately.
2. Participants are held responsible for the implications of their decisions.
3. The impact of many possible alternatives can be examined and evaluated.
4. Each member in the team gets an opportunity to take part in the decision making.
5. Interest of the participants can be sustained for a longer period of time as they remain emotionally involved without any tension.
6. It facilitates learning as complex and critical situation is given for decision making which resembles the real life situation.





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7. As managers from different functional areas are put in the team, managers can be made aware of other functional areas.
8. The implications of decisions and long term policies can be shown in the game.
9. The difference that the systematic planned approach brings in the efficiency can be demonstrated.
10. Young new entrants get a chance to work with the senior employees in the team and this helps in developing their perspective on the company as a whole.
11. Cooperation and coordination, among departments' increases as inter departmental conflicts get reduced.
12. As team members are asked to finish the work within the time limits, it resembles real life situation.
13. This method is less costly and can be organized with minimum efforts.

## Limitations:

1. As teams have to confine their thinking to the rigid situations given, it blocks originality.
2. The employees have to suggest logical solutions on the basis of the fixed data given which can be opposite to the fact prevailing in reality.

## 5. Business Game:

In this method participant trainees are divided into different teams. All these teams have to compete with one another. These games are designed on real life situations. Generally, each team, comprising 2 to 6 members, represents a company. Here, participants have to assume different roles while taking decisions on pricing, production, promotion and advertising, research expenditure, etc. in the market- like simulated atmosphere in the classroom. This exercise continues for some pre-fixed time period and every time the decisions taken by different teams are fed into the computer programme which is developed according to some market model. At the end, result for each team is worked out and performance of different teams would be compared on the basis of the end result.

## Advantages:

1. Business games teach trainees how to take management decisions in an integrated manner wherein the effects of all possible factors are to be considered.
2. It develops the skill of separating the relevant data from the mass of data which can help in decision making. Moreover, it teaches the participants how to take effective decision even when the information available is incomplete.
3. It develops the abilities of the participants to take decisions in an uncertain environment.
4. As the learning takes place in the form of game, it creates and sustains the interest of the participants.
5. It helps in developing the problem solving skills of the employees.
6. As participant trainees are put to perform different roles, their understanding regarding the difficulties involved in different jobs increases.





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3- Vaishalinagar  
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2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## Disadvantages:

1. In majority of the cases, participants are asked to select the alternatives from the given list whereas in real life situation this is not the case. Thus, it does not prepare the trainees to face real life situation in real sense of the term.
2. In management games, an attempt is made to create real life situation in the class room but exactly, they can never be realistic completely so the success in the business games does not guarantee the success in real world.
3. It is expensive to develop and put into practice management games, particularly in case of computerized games.

## 6. Sensitivity Training:

This method is popularly known as T-group training. The method aims at making employees more sensitive towards their own behavior and behaviour of others.

According to Chris Argyris, "sensitivity training is the group experience designed to provide maximum possible opportunity for the individuals to expose their behaviour, give and receive feedback, experiment with new behaviour and develop awareness of self and of others."

In this method, participants are divided into small groups having 10 to 12 members in each group. The group members interact with each other throughout the training period and the role played by each one would not be structured or planned. Some training assignments are given to the group to provide the base for group interaction. As such there is no fixed objective to be achieved or no fixed agenda for the discussion. Free and open discussion on behavioural patterns and attitudes is encouraged. It induces the participants to think over their own behaviour and its impact on others, i.e. they are stimulated to do introspection. At the same point of time, their understanding towards others' feelings and emotions increases.

## Advantages:

1. It increases self-awareness. Employees become aware of their own strong as well as weak points.
2. It develops understanding on the impact of their behaviour on others and others' behaviour on them.
3. It sharpens the ability of dealing with human beings.
4. Trainees learn how to work effectively in groups and how come out of human relation issues.
5. It helps in solving inter-personal problems smoothly.

## Disadvantages:

1. Participants' learning gets lost when they get back to the actual work environment after the training as the actual work situation is mainly characterized by company policy, rules and, regulations and other such restrictive factors that are insensitive.
2. Sometimes, the learning gets so much fixed in the minds of the employees that they become very much sensitive towards the feeling of others and this makes them ineffective for taking hard and strict decisions.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

3. As many times, such training creates stress situation leading to increase in the distance between employees rather than reducing it.
4. At times this kind of training induces anxiety with all its adverse effects on the employees.
5. This method does not work well for all types of work. For example, it is not a suitable method of training for technical profession.

## 7. Simulation:

Under this method, duplicate situation is created which resembles the real organizational situation. The trainee is made to feel that he/she is actually facing all those conditions and circumstances.

Here, a case on real organizational activities covering all its important characteristics is created which is not to be studied and analyzed but it is to be lived and experienced by the trainees. Trainees have to play different roles in the given situation in such a way that they remain themselves while performing their roles. Problems faced are to be solved and decisions are to be taken. Trainees receive immediate feedback on their performance.

The main **advantage** of this method is that an attempt is made to create a learning environment that resembles the real life situation without incurring heavy cost.

The **disadvantage** of this method is the difficulty that is faced in duplicating the situation to that extent that the employees feel the pressure of actual decision making on the job.

Moreover, as employees are aware of the fact that a situation is artificially created for learning purpose, they cannot have the feeling of real job experience. So their behaviour would always differ in the simulated exercise and in the real-life situation.

## 8. Conferences:

Conference is a formal meeting of people that is conducted to discuss the points and subject of common interest. Here, participating trainees contribute orally and leader tries to develop knowledge on the basis of the contributions of the participants. In conference, discussions take place on the defined subject matter according to pre-determined plan. Active involvement and participation of the trainees is emphasized. Each participant builds upon the ideas of other participants and thus learning is facilitated.

### Advantages:

1. This method is more suitable when the need is to analyze the problem from different viewpoints.
2. Participants try to come to common conclusions and solutions of the problem which are acceptable to them.
3. This method becomes instrumental in increasing the ability of participants to change their attitudes.

### Limitations:

1. To ensure active participation of all the members, the size of the group has to be small. Thus, it cannot be used for large group.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
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Ph.No–(0281)2440478, 2472590

2. It consumes more time as each participating trainee is allowed to speak on the topic.

The essentials for the effectiveness of this method:

1. The participating trainees should have some knowledge on the subject on which the conference is to be held.
2. The leader has to be effective and inspiring.
3. The size of the group should be small to ensure effective participation of all the members.

## 9.Lectures:

This is one of the simplest methods to use when the trainees are to be given the knowledge on facts, theories, concepts and principles. Lecture is a formal talk prepared by the training specialist. This is widely used method where the training is to be imparted to a large number of persons in a short period of time. This method is particularly of great use when technical and complicated information is to be given to the trainees. Use of audio-visual aids increases the effectiveness of the lecture method.

## Advantages:

1. Lecture method proves useful in the introduction of changes as the need and purpose of the change can be explained to the employees before introducing it in the organization.
2. Many employees can be trained at a time with the help of this method.
3. In shorter period of time, many things can be covered. Thus, it is time saving method.
4. The overview and the scope of the subject can be presented very clearly with the help of lecture method.
5. Material providing the background for the subsequent activities can be provided with the help of this method.

## Disadvantages:

1. The lecture method does not leave any scope for participants' learning as it is one way communication. The principle of learning- learning by doing- is not followed.
2. A sufficiently motivated person also can pay attention for maximum 20 minutes. When lecture exceeds beyond that, listeners would lose the attention.
3. It takes too much time to prepare verbal presentation for the lecture. Moreover, its presentation requires speaking skills without which it does not produce desired result.
4. If too much information is imparted to the listeners in a lecture session, it becomes difficult for participants to understand it at a point of time.
5. With the help of lecture method, knowledge can be given but its application cannot be taught.
6. The content and presentation in lecture method is set according to the common requirements of the participants. It cannot address specific individual requirements.



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## Following are the essential points to be kept in view while using lecture method:

1. The lecture should be planned so far its content, coverage and presentation are concerned.
2. It should be made as interesting as possible to ensure effective Learning.
3. As speaker has to perform very important role in this method, one has to be enthusiastic and at the same time, one has to keep the requirements, knowledge level and interest of participants in mind.
4. The time for the lecture should not be very short; it should not be very long also.
5. To the extent possible, lecture should be made interactive. Questions should be put in front of participants on whom they can express their views freely.

## 10. Other Methods:

### • Audio – Visuals

Audio visual aids like television, presentation slides, videos and films can be combined with lecture method

Provides a broad range of real life examples on different job conditions in a limited time

The disadvantage is that most of the time it has only one way communication

Also does not provide the flexibility to change the presentation from audience to audience

### • Programmed Instructions (PI)

Training is offered without the intervention of a trainer

Material is provided to the trainee in blocks through a teaching machine

After going through the material, trainee needs to respond to the questions asked

Feedback on the responses provided is given

Same block of material is repeated if the answers are not correct or else the learner advances to the next block of material

### • Computer Assisted Instructions (CAI)

The extension of PI method is CAI

Management can keep a check on each trainee's performance and needs as tests are taken on the computer

Provides flexibility in sense that training program can be modified according to the technological changes in the process

Trainees can use computer anytime as they want, providing flexibility in terms of timing

It is also known as self paced learning

## EVALUATING TRAINING EFFECTIVENESS

- 1. Need for evaluation
- 2. Principles of evaluation
- 3. Techniques of evaluation
- 4. Levels of evaluation



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

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## Need for evaluation

- The primary objective of training program is to correct performance deficiency. Evaluation is necessary to determine whether training program has achieved its objective or not
- It is needed to ensure that the change in trainee's capabilities is because of training and not because of any other reason
- It is carried out to determine the cost effectiveness of training program
- If evaluation proves that the firm has benefited tangibly from training program, credibility of the training program gets enhanced
- The success or failure of the training program can be judged on the basis of evaluation

## Principles of evaluation

- The goals and objectives of the evaluation should be very clear to the evaluation specialist
- It should be specific and continuous
- It should provide the means with the help of which trainees can appraise themselves
- The methods used for evaluation should be standard
- It should be time bound in the sense that realistic target schedule should be pre determined for each phase of evaluation and it should be adhered to.

## Techniques of evaluation

### • Experimental and control groups

Two groups of employees are randomly selected - one group is to receive training called experimental group and one that is not to receive training is called control group

Several success indicators are measured before and after the training for both the groups

If the gains obtained by the experimental groups are better than those obtained by control group then it is concluded that training is successful

### • Longitudinal and time series analysis

Success indicators are measured before the program begins, continues during the program and even after the program is completed

To examine the result of the training program, these measurements are plotted on the graph

It clearly indicates the change that has taken place in the success indicators because of training

Here control group can be included to validate that the changes have taken place as a result of training

### • Direct inputs from the trainees

Questionnaire is a commonly used tool with the help of which information on the opinion about the worth of the program can be directly collected from the trainees

Interview is another tool to collect such information



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A variant of this method is to measure the knowledge and skills of trainees at the time of commencement and after the completion of program

True assesment of the training program is done in terms of cost benefit analysis

## Levels of evaluation

This four level model of evaluation is given by: Donald Kirkpatrick

- RESULT
- BEHAVIOUR
- LEARNING
- REACTION

### 1. Reaction

- It measures whether training program is liked by the trainees or not
- The questions that are asked at this level is:
  - Did the trainees like the program, content, trainer, facilities?
  - Are they of the opinion that the course was helpful?
  - Do they like to suggest any improvement?
- Generally reaction is measured with the help of questionnaire.

### 2. Learning

- It measures how much employees know more after the training than they did prior to undergoing training
- The relevant questions at this stage are:
  - Do trainees have great knowledge or skills after undergoing training?
  - If yes to what extent?
- Here, a series of tests like performance tests, graded simulations are used

### 3. Behavior

- It measures the behaviour of the employees on the job after the training
- The relevant questions asked are:
  - Is there any difference in the behaviour of trainees after the training?
  - Is knowledge and skill acquired in the training used by the employees?
- This behavioral impact is measured by performance appraisal by peers, superior, subordinates or clients

### 4. Result

- It examines the overall outcome and impact of training on the organisation





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Ph.No–(0281)2440478, 2472590

- Questions to be asked are:
  - Has the organisation become better after the training?
  - What is the impact of training in terms of productivity, quality, efficiency and moral or customer service?
- Here, the measurement is done in terms of sales figures, production volume, customer survey or any such relevant means

## CAREER PLANNING AND CAREER DEVELOPMENT :

- Career planning and career developments have become important and relevant at individual level as well as at organizational level.
- Individual career planning has gained importance in view of the increase in the educational facilities as well as job opportunities. Organizational career planning has become important due to technological advancements, emergence of large-sized organizations, changing human needs and values, etc.
- A career is a series of jobs that are held during one's working life. Career -planning is an exercise which determines the objectives one wants to achieve in one's work life and the course of action to be taken to achieve those objectives.
- Career development is one's development that results while putting career plan into practice. Following definitions given by different experts:

**'A career is a sequence of separate but related work activities that provides continuity, order and meaning in a person's life.' - Edwin Flippo**

"A career is an individually perceived sequence of attitudes and behaviors associated with work related experiences and activities over the span of the person's life." - Douglas T Hall

"Career planning is the process by which one selects career goals and the path to these goals. Wrether and Davis

"Career development is those personal improvements one undertakes to - Wrether and Davis achieve a personal career plan."

### **Benefits to Individuals**

- Develops understanding and knowledge of an individual regarding various available career opportunities and his or her priorities
- Helps an individual in selecting the career that best suits his or her choice, lifestyle, family environment etc.
- Makes the work of internal promotion easier in an organisation as the most fit employees for promotion can be identified





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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- Facilitates internal promotions and transfers and leads to increase in the morale and job satisfaction of employees
- Satisfied workforce remains committed and loyal to the organisation
- Employee turnover can be brought down as employees would prefer waiting for their turn for promotion rather than leaving the organisation
- Helps employees use their potential to the optimum extent leading to employee growth
- Fulfills self esteem needs of employees

## **Benefits to the Organization**

- Availability of human resources with required skills and knowledge is made possible
- Highly talented employees can be attracted and retained in the organisation with proper career Planning and development practices
- Equitable career opportunities can be made available to women and people belonging to backward communities
- Employees frustration can be brought down as a systematic career planning and development process tries to satisfy the expectations of employees
- Helps in enhancing cultural diversity as people from different cultures can be attracted and retained in the organisation
- As interest of the employees are taken care of with the help of career planning and development, goodwill of organisation improves.

## **MANAGEMENT DEVELOPMENT**

- Management development is the overall concept that describes the many ways in which organizations help employees develop their personal and organizational skills, either as managers in a management job or with an eventual management job in mind.
- Organizations need a process for developing the skills of their managers as these employees direct and organize the work of all of your other employees.
- Additionally, if you want to retain your best managers and potential managers, most significant among their needs from work is the opportunity to continue their personal and professional growth and the growth of their careers.
- When employees think of management development, they are likely to think about university classes and MBA programs, consultant-led external training, and attendance at conferences, trade shows, workshops, and seminars.
- These are frequent ways in which employers invest time and money in developing their managers.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## Important Objectives of Management Development

- To increase the morale of the employees
- To improve the performance of the managers
- To keep the managers and executives aware about the developments in their respective fields
- To improve decision making, problem solving and analytical abilities
- To widen the perspective of the manager in the matters concerning their roles and responsibilities
- To develop an understanding on the conceptual issues relating to economic, social and Technological areas
- To improve human relations skills
- To develop a versatile management team
- To encourage Creative Thinking
- To identify persons with good potential so as to prepare them for higher positions

## Need for having Management Development Programs

- Managers having expertise in technical areas like mechanical engineer, system engineer, require development in the areas of managerial knowledge and skills
- Overall professionalization of Management in the sector determines the efficiency of the functioning of public utilities, communication, transport etc.
- Overall professionalized approach in the organisation necessitates development of managerial skills and abilities at all levels in the organisation
- Development of managers is needed in the changed environment characterized by liberalisation, privatisation and globalisation
- Multifaceted development of human resources of organisation
- Deployment of specific strategies
- Imparting technical and conceptual skills to non technical managers
- Introduction of many new concepts in the field of Management (total quality management, employee empowerment, etc.)
- As MNC bring with them new Trends and strategies, domestic companies need to arrange for management development program for the managers

## Principles for making MDP effective

- Proper assessment of development needs of the managers with the help of performance analysis and development methods
- Career Planning and development of organisation should be well integrated with MDP



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

**3- Vaishalinagar**  
**Nr. Amrapali Railway Crossing**  
**Raiya Road, Rajkot – 360001**  
**Ph. No–(0281)2471645**

**2 – Vaishalinagar**  
**Nr. Amrapali Railway Crossing**  
**Raiya Road, Rajkot - 360001**  
**Ph.No–(0281)2440478, 2472590**

- The responsibility for developing managers of different units of organisation should be decentralized and Department Head should be made responsible
- Managers at different level should be sufficiently motivated to take up MDP to avoid obsolescence in terms of Knowledge as well as skills
- Management development should be viewed as a continuous activity
- Managers should be encouraged to attend MDP organised by outside professional agencies
- Apart from sponsored programs, managers should be motivated to take up MDP on their own
- The physical, social and psychological environment conducive to MDP should prevail in the organisation
- The content of the program should be designed keeping in view the need of individual managers
- Latest management concepts, principles and theories should be emphasized in MDP



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3- Vaishalinagar  
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Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

## UNIT – 4

### PERFORMANCE APPRAISAL AND COMPENSATION

#### PERFORMANCE APPRAISAL

Performance Appraisal is a systematic evaluation of personnel by superiors or others who are familiar with their work and performance.”

- 'Performance Appraisal is a systematic appraisal of employee traits and performance on the job and is designed to determine employees' contribution and relative worth to the firm.”
- An employee value is ascertained keeping in view his expertise, insight, cleverness, productivity, capacity etc. Employee's merit rating in its broader sense called employee's performance appraisal."
- In short, to evaluate the efficiency and future capacity of employee called performance appraisal.

#### **FEATURES / CHARACTERISTICS:**

- 1.It is a systematic process which involves (a) Determining standards of performance. (b) Comparing actual performance of the employee with predetermined standards. (c) Providing feedback to the employee about the strengths in his performance as well as weaknesses and suggesting measures to improve performance over a definite period of time.
- 2.It is a humanly carried out process usually by supervisors or higher level authority.
- 3.It is the process to assess the present performance of an employee and establishes steps for improvement in future.
- 4.It is a periodic activity carried out regularly at the completion of the definite period of time i.e. 3 months, 6 months, annually.
- 5.It is a forward looking activity to bring about corrections and improvements in future performance.
- 6.It is a development oriented activity and not a fault finding process.
- 7.It can be formally or informally conducted but it should be fair and equitable.
- 8.Personal bias and judgmental approach should be avoided while appraising performance and determining the appraisal system.
- 9.It is an inevitable tool for taking decisions related to human resource.

#### **OBJECTIVES:**

- 1) To maintain records in order to determine compensation packages, wage structure, salaries raises, etc.
- 2) To identify the strengths and weakness of employees to place right men on right job.
- 3) To maintain and assess the potential presence in a person for further growth and development.
- 4) To provide a feedback to employees regarding their performance and related status.
- 5) It serves as a basis of influencing working habits of the employees.



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- 6) To review retain the promotional and the other training programmes.
- 7) To provide coaching and counselling.
- 8) To provide valid database.

## PROCESS OF PERFORMANCE APPRAISAL:

### 1. **Establishing and communicating standards of performance:**

Any appraisal system requires the setting of standard of performance which acts as the base for measuring performance. Job description act as a source to develop performance standards. The job description makes it clear to an employee what he is expected to do on job. This also helps an employee to set his own goals and targets.

### 2. **Measuring actual performance of employees:**

Every employee's performance needs to be measured. To facilitate this personal observation, oral and written reports and statistical reports are used as techniques. However, performance measures should be fair, easy and reliable. Objective criteria for performance measurement include measurement of absenteeism, tenure of service, production quality, and training requirements.

### 3. **Compare actual performance with standards and provide feedback:**

When the actual performance of an employee is compared with standards or benchmarks, it could be found whether actual performance is better than expected performance; or is there a deviation. Any type of appraisal needs to be communicated systematically since it affects the satisfaction level and self esteem of an employee. Care needs to be taken that appraisals do not lead to negative consequences but enable an employee to improve upon his weaknesses.

### 4. **Corrective Action:**

Corrective action is a step taken to set things properly and to get the employee back to standard performance. It enables an employee to understand the reasons for deviations in performance so that they could be corrected permanently.

## **Topic: Explain the methods of performance appraisal.**

### • **Techniques of PA**

#### • **Traditional**

- Ranking method
- Paired comparison method
- Graphic rating scale
- Grading method
- Essay or free form appraisal
- Forced choice description method



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- Confidential reports
- Group appraisal
- Checklist method
- Critical incident method
- **Modern**
  - MBO
  - Human resource accounting
  - BARS
  - Assessment center method
  - Balance Scorecard
  - Result method
  - Productivity measures
  - Behavior observation scales (BOS)
  - 360 degree appraisal

## TRADITIONAL TECHNIQUES:

### 1. Ranking Method:

It is the oldest and simplest formal systematic method of performance appraisal in which employee is compared with all others for the purpose of placing order of worth. The employees are ranked from the highest to the lowest or from the best to the worst. There is no classification of different parameters of work. Only total performance is considered.

#### Merits

- Relatively easy to understand and implement
- Economical
- Fast and convenient
- Helps separate efficient and inefficient employees

#### Demerits

- Not suitable when number of employees are large
- There might not be much difference between the employees ranked before/after each other
- Rater's personal bias
- Does not consider different attributes

### 2. Paired Comparison Method:



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- Method of evaluation in which each employee and job is compared with each other employee and job. Employee comparisons are performed usually on the basis of overall performance, whereas job-evaluations are usually on the basis of skill, knowledge, and time required in their performance.
- Scores derived from paired comparison are often compared with the standard deviation and mean of all scores to arrive at standard Scores for future comparisons.
- Total number of employees (or jobs), however, places a limitation on this method because such comparisons require  $N(N - 1) \div 2$  pairs (where N is the number of employees or jobs being compared).
- Hence, a firm with just 10 employees (or jobs) will have 45 pairs to be compared.

## Merits

- Better compared to ranking method
- Compares one employee with another on total performance criteria and so helps to identify efficient employees
- Economical

## Demerits

- Not easy to implement and understand
- Impossible to use in case of large organizations
- Confusing and biased

## 3. Graphic Rating Scales:

- This method compares an employee's performance to the performance standards set by the company. Judgments about performance are recorded on a linear scale.
- This method is also known as a simple rating scale or Linear rating scale.
- The appraiser is provided one form per employee and it covers various parameters of performance and employee characteristics such as quality of work, job knowledge, initiative, attitude, cooperativeness and in case of managers it covers criteria like creativity, analytical ability, emotional stability, etc.
- These forms contain rating scales which may be continuous or discontinuous where the rater can assign points as per his judgment

## Merits

- Oldest and widely used
- Better and more reliable results
- Clearly shows which employee is better
- Strengths and weaknesses of each employee
- Can provide useful feedback
- Comparison of scores among employees

## Demerits

- Time consuming





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- Personal bias of rater
- Needs expertise to design
- Expensive
- Only practical applications are given ratings
- Equal weightage to each characteristics even if it is not highly important point

#### 4. Grading Method

- In this method the rater considers certain features of an employee and make a scale accordingly
- Certain categories are established and properly defined and then grades for each feature is defined
- The selected features for appraisal of employees may include self expression, dependability, leadership qualities, job knowledge, planning ability, etc.
- The actual performance of an employee is then compared with the grade definitions and the grade that best describes employee's performance is allotted to him
- The grades could be defined as:
  - Grade A = outstanding
  - Grade B = very good
  - Grade C = good
  - Grade D = fair or satisfactory
  - Grade E = poor

**Example:** Grades in school/ college results

#### Merits

- Easy to understand and implement
- Most suitable for large organisations and those having greater number of employees
- Two employees with same performance can enjoy same grades
- Performances of employees across the departments may not be easily comparable using other methods but through this method most efficient and Competent employees across departments can be identified
- Motivates employees

#### Demerits

- Deciding a grade for a level of performance needs expertise at hence more expensive
- Demotivates the best performing employee since they are graded as few less well performing employees
- Difficult to provide feedback to improve performance

#### 5. Essay Or Free Form Appraisal

- Under this method the rater writes an essay describing the employee's overall performance. He makes a free form, open minded appraisal of an employee in his own words and puts down his impressions about an employee.



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- The rater takes note of various factors like general planning and organising ability, relations with fellow workers and subordinates, understanding of company policies and procedures, regularity, employee characteristics and attitudes, job knowledge and potential for growth and development needed for future.
- All the above factors are described factually and concretely. The evaluator writes about the qualitative performance of an employee in terms of the above discussed factor

## Merits

- It can provide a lot of information for the person reading the report and leaves no doubt or confusion
- The reports presented are relatively more convincing as the supervisor can provide two or three examples about the judgement made by him
- Evaluator can prepare a comprehensive essay by including all the factors related to performance

## Demerits

- Very time consuming
- Subjective evaluation - might include prejudice
- Not feasible when there are large number of employees
- Rater may be poor at describing
- Interpretation maybe difficult and different from what is expressed

## 6. Forced Choice Method:

- In this method, a set of four statements are formed, two of which are positive and two of them are negative.
- Several such sets of statements are prepared and the rater/ appraiser is asked to select two statements of four in each set which describes the employee the most and which describes him the least respectively.
- The positive qualities of an employee get a plus credit and negative qualities get a minus credit.
- The personnel department handles the work of giving marks. He mentions M for most applicable and L for least applicable.

## Advantages:

- It helps in evaluating a person /employee objectively.
- It is very popular method and extensively used by organizations.
- The method is free from element of partiality and favoritism.

## Disadvantages:

- It is very expensive since the preparation of statements requires the help of experienced and trained professionals.
- Managers feel frustrated since they do not have a clear picture about how they are evaluating an individual employee.



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- The results of this Method do not provide inputs for determining training needs since the rater himself is not clear of how he is evaluating an employee.
- Sometimes, all statements in a group may or may not apply to a single person but the rater is forced to make a choice of most and least applicable in each group.

## 7. Confidential Report:

- This is a traditional technique of Performance Appraisal. It is widely used in government organizations.
- The supervisor evaluates the performance of his subordinates. Based on his evaluation, he prepares a descriptive report, which highlights the strengths and weaknesses of the subordinate.
- This report is usually prepared at the end of the year and no feedback is provided to the employee based on this report.
- It is kept confidential and the subordinate or employee does not know what has been reported by his superior nor is he aware about how he has been rated.
- This report includes the strengths, weaknesses, commitment, punctuality, conduct, character, friendliness, attendance etc. of the subordinate.
- Confidential report plays an important role for solving the problems of employees like promotion, transfer, demotion, termination etc. With the help of confidential report the problems of employees can be easily and fairly solved.

## Merits

- Detailed information can be evaluated
- Areas for improvement can be identified
- In depth analysis of the employee can be done

## Limitations:

- It is highly subjective and the report may be biased or prejudiced.
- The supervisors' observations and judgment may not be correct.
- Employees and trade unions do not prefer this method since it does not give a clear picture to them about their own evaluation.
- The quality of report depends upon the capability and communication skills of the appraisers.

## 8. GROUP APPRAISAL METHOD

- In this method, a group of appraisals are appointed to conduct the performance appraisal.
- The group of raters may include immediate supervisor, head of department and head of some other departments or an HR executive.
- They observe and employee's performance during the appraisal period and accordingly the report is prepared



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## Merits

- Reduces the chances of personal bias
- Less subjective because many raters are involved which ensures evaluation from various perspectives

## Demerits

- It is expensive as more than one person is involved in appraisal process
- There can be problem and making unanimous decision
- It is time consuming

## 9. CHECKLIST METHOD

This method is simple in which supervisor is given list of statements or words and he is asked to check statements which match employees traits and performance. There are two types:

### A. Simple checklist:

This method involves a large number of statements about employee's behaviour and the rater checks to show whether the behaviour of an employee is positive or negative in case of each statement. The negatives are not considered and the employee's performance is judged on the basis of positive checks. The only problem is each statement could be interpreted differently by different raters. So result may not be totally reliable.

### B. Weighted checklist:

In this method, some statements carry more importance and hence more weights (points) may be assigned to different items or statements. The rating scale is not provided along with the questionnaire. The supervisor is only expected to tick those traits that match an employee's behaviour. Then someone else is allotted the responsibility to compute the scores based on the weights assigned in the rating scale. Performance ratings of an employee are multiplied by the weight of the statements and points are added up. These cumulative points indicate the weighted performance score of an employee. This is then compared with the overall standard in order to judge the overall performance of employee

## Merits

- It provides very objective and evaluative report
- It helps in developing employees by assessing them neutrally and providing feedback on positives

## Demerits

- This method is very expensive to design
- Every organisation has to develop a separate checklist for each job
- The evaluator does not know which items on the checklist contributes to successful performance and so it is not widely accepted



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## 10. THE CRITICAL INCIDENT METHOD

This method is based on the approach that there are key acts of behavior of an employee that makes a difference between success and failure on the job. The rater records such events and incidents which occurs in the performance of the job. Refusal to help another employee, refusal to take further training etc. The incidents collected are rated. Provides sound basis for appraisal

### Merits

- Based on direct observations
- Employee's recent behavior can be understood
- Each employee can be understood personally

### Demerits

- Difficult to decide whether critical or exceptional
- Can't be used in small scale organizations
- Can't be used for employees working at lower levels

## MODERN TECHNIQUES:

### 1. Management By Objectives (MBO):

- This is a method of evaluating employee's performance based on their achievements or accomplishments.
- It was developed by peter Drucker in 1954 but it is only during the last two decades that organizations have started adopting MBO as an appraisal technique.
- It is the process by which superior, subordinates and managers of an organization jointly set common goals and define major areas of responsibility for each individual and then use them for operating the business and assessing employee's contributions towards it.
- During the appraisal, the superior and subordinate update and after goals is required to adapt to changing environment.
- Then, they jointly discuss whether goals were achieved or not, identify reasons for deviation and set new goals and performance objectives for the next period based on performance levels.

### Steps in MBO Process:

1. Set organizational goals for next year or set company goals.
2. Set departmental goals jointly by departmental heads and superiors.
3. Discuss departmental goals and set individual goals jointly by departmental heads & subordinates.



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4. Define expected results. Set short term individual performance targets.
5. Performance Reviews.
6. Provide feedback.

## Advantages of MBO - an Appraisal Technique:

1. It is a positive technique to help an employee improve his performance by developing his strengths and overcoming weakness.
2. It helps to identify organizational weaknesses like delegation, ineffective communication etc.
3. It helps to identify non-performers.
4. It focuses and facilitates optimization of goals.
5. It enables to get people's commitment to set goals and perform at higher levels.
6. It focuses on effective planning for accomplishment and controlling through a set of predetermined goals.

## Disadvantages:

1. Setting goals that are measurable and attainable is not easy.
2. It is time consuming and needs a lot of paper work.
3. MBO concept is more on paper rather being practically implemented.
4. Individual goals differ from person to person hence comparative ratings or merit rating become difficult.
5. MBO deals with appraisal of present job and does not help in identifying the potential capacity of employees.
6. It presupposes the determination of tangible and appropriate goals by individuals but many a times employees set goals which are too low and not challenging or set goals that are unattainable.
7. It presumes certain level of trust and responsibility at all levels throughout the organization.

## 1. Human resource accounting

- HRA is a method of performance appraisal which involves attaching money estimates to the value of firm's internal human organisation and its external customer's goodwill. If able and well trained personnel leave the firm, then the HR organisation is worthless but if such employees join the firm or are retained by the organisation, its Human Assets increase
- If distress and conflict prevail, the enterprise is devalued
- HRA deals with cost and contribution of human resources to the organisation
- Cost include cost of manpower planning, recruitment, selection, induction, placement, training, wages and benefits, development, welfare, etc.
- Contribution is the money value of employees service to the organisation which is measured by value added by personnel or by labour productivity ratio



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- Employee performance is considered positive when contribution made by him is more than the cost and negative when cost is more
- ITC and Bank of Baroda tried to implement this method but have not succeeded fully

## Merits

- Helps human resource professionals and senior managers to use human resources of an organization efficiently and effectively.
- intended to provide the users with information to acquire, develop, allocate, conserve, reward and utilize human resources.
- measures the cost and the value of people in an organization for use in a variety of management decisions.

## Demerits

- There is no specific guideline for measuring the cost and value of human resources.
- While valuing the human assets, demand for rewards and compensation might be higher.
- The nature of amortization to be followed is yet to be fixed up.
- Tax laws do not recognize human assets and in that sense, it might be theoretically only.

## 2. BEHAVIORALLY ANCHORED RATING SCALES (BARS)

- Behaviorally anchored rating scale is a measuring system which rates employees or trainees according to their performance and specific behavioral patterns.
- BARS is designed to bring the benefits of both quantitative and qualitative data to employee appraisal process as it mechanism combines the benefits of narratives, critical incidents and quantified ratings.

### The procedure for BARS consists of 5 steps:

- **Generating critical incidents:** Employees having knowledge of the job and to be appraised are asked to describe the specific effective and ineffective job performance behavior
- **Develop performance dimensions:** These employees then cluster the incident and define it in a set of 5 to 10 performance dimensions like ability, knowledge, human relations ability, skills in monetary transaction, judgment etc.
- **Reallocate incidents:** Any group of person who also know the job or experts then reallocate the critical incidents. They are given clusters, definitions and Critical incidents and asked to redesign each incident to the dimensions that describe it the best. A critical incident is retain for appraisal if 50 to 80% of cluster descriptions given by the group matches with the previous employee's a cluster description.





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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- **Scale of incidence:** The second group generally is also expected to rate the behaviour described in the incident as to how effectively or ineffectively it represents performance. Usually a seven point or a 9 point scale is typical and the 7 point scale ranges from extremely poor to extremely good.
- **Developed the final instrument:** Subset of incidents usually 6 or 7 per cluster are used as behaviour anchors for the performance dimensions

## Merits

- The critical incidents along the scale helps to clarify what is meant by extremely good performance to poor performance thereby setting clear standards of performance
- More useful in providing feedback
- As it is done by experts in this technique, it is more accurate
- This method is independent of bias or influence of the nature

## Demerits

- Complicated and confusing
- Can't be used for all employees since all of them don't face critical incidents
- Expensive and time consuming

## 3. ASSESSMENT CENTRE METHOD

- This method was initially applied to military situations in the German Army. The purpose of this method was to test candidates in a social situation using a number of assessors and a variety of procedures.
- The most important feature of an assessment Centre is job related simulation which involves characteristics which managers feel are important to job success.
- The evaluators observe and evaluate participants as they perform the activities. Under this method, many evaluators join together to judge an employee's performance in several situations.
- They use a variety of criteria for appraisal. Assessments are done to determine employees potential for the purpose of promotion.
- These assessments involve paper and pencil test, interview and situation exercises like role playing, business games, incidents, etc..
- Evaluators are experienced managers with proven ability at different levels of Management. They evaluate all employees individually as well as collectively. Finally a summary report is prepared.
- The duration of the appraisal depends upon the number of persons and positions for which appraisals are being done

## Merits

- It is very useful for selecting employees for first level supervisory positions and sales personnel
- Not all employees have to be appraised, only selected ones are to be appraised



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## Demerits

- ▶ The ratings are strongly influenced by interpersonal skills of the participants
- ▶ The assessment done through exams and tests at times suffocates performers in a simulated environment
- ▶ Immediate supervisors nominate participants and hence can be element of bias

## 4. THE BALANCED SCORECARD

This technique was developed by Robert Kaplan and David Norton. This method brings linkages among financial, customers, processes and learning. Learning and people management contribute to the improvement of internal processes which in turn leads to increase in customer satisfaction and loyalty. Customer satisfaction leads to customer value creation which impacts financial performance and profitability

**The following things can be done in order to use this concept for managing performance:**

- ▶ a. Translate the strategy into scorecard of clear objectives
- ▶ b. Attach measures to each objective in order to assess their achievement
- ▶ c. Give scorecard even to the lowest level employees so that they are able to know and understand how their duties are associated with higher level goals and objectives
- ▶ d. Provide feedback on performance based on measures set
- ▶ e. Empower employees for improving performance
- ▶ f. There should be reassessment and continuous changes and adjustments to the strategy by the management based on feedback

The Four Perspectives in More Detail		
Perspective	Focus	Example KPIs
Financial	Financial Performance	ROI Operating Margin
Customer	Customer Satisfaction	Level of returns Service rating
Internal Processes	Business Efficiency	New product lead time Unit costs
Organisational Capacity	Knowledge & Innovation	Employee retention Flow of NPD ideas

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3- Vaishalinagar  
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2 – Vaishalinagar  
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Ph.No–(0281)2440478, 2472590

## Merits

- ▶ Bring structure to business strategy
- ▶ Makes communication easier
- ▶ Facilitate better alignment
- ▶ Connect the individual worker to organisational goals

## Demerits

- ▶ Takes a lot of time and effort as it must be tailored to the organisation
- ▶ It can get complicated
- ▶ It requires lot of data

## 5. RESULTS METHOD

- Modern organisations evaluate employees based on accomplishments or achievements and not on their traits or behavior.
- These achievements include sales turnover, number of units produced, number of complaints settled, number of customers handled, return on investment, etc.

## Merits

- This method is less subjective or prejudiced
- Assigns responsibility clearly to each employee
- Empowers employees
- Gives freedom to the employees to work using different method

## Demerits

- Ignores very important qualitative aspects like customer satisfaction etc.
- The results are sometime influenced by various external factors which affects their results and employees have no control over them
- Encourages employees to work with short term perspectives for getting higher ratings

## 6. PRODUCTIVITY MEASURES

- Under this method, an employee is appraised based on the ratio of output to input they used. Example: Sales to employees salary and benefits, number of customers handled per day.
- Only problem with this method is measuring output as well as input may not be possible in all cases

## 360 degree method:



# SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
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- This is a method of collecting information about performance from one's subordinates, peers, supervisor's customers and one's own self.
- It is a technique to find facts, problems and self-correction. Nowadays, it is used as technique to support promotion decisions.
- It is a tool to create an atmosphere of team work and improvement. This tool needs to be designed and implemented properly, systematically.
- This type of appraisal can be done by using certain software's developed by a number of companies. It is also known as multisource assessment.

## **Advantages:**

1. It provides high quality of information from respondents.
2. It is a comprehensive system for collecting data from various sources.
3. It is consistent with TQM (Total Quality Management) as internal and external customers are involved.
4. It discloses truths about the organizational practices, work culture and ambience
5. It reveals strengths & weaknesses of the organization.
6. It motivates employees to become flexible and leads to self development of employees.
7. It is a method free from bias.

## **Disadvantages:**

1. The appraisee usually does not accept negative feedback disclosed by this method.
2. This method can be used to .humiliate or disrespect people.
3. It is a complex system and views of appraisers usually are contradicting.
4. Appraisers cannot be held accountable since they do not take any responsibility of evaluating.
5. Appraisers if not trained, would not be able to adopt this system effectively.
6. If rewards are based on the findings of 360 degree appraisals, they may not be fair.

## **COMPENSATION:**

- In very simple terms, compensation is the results or rewards that the employees receive in return for their work. Compensation includes payments like bonuses, profit sharing, overtime pay, recognition rewards and sales commission, etc.
- Compensation can also include non-monetary perks like a company-paid car, company-paid housing and stock opportunities. Compensation is a vital part of human resource management, which helps in encouraging the employees and improving organizational effectiveness.
- From a manager's point of view, the compensation package offered to a company's employees is essential not only because it costs money, but because it is likely to be the primary reason the employees work for the firm.
- Compensation packages with good pay and advantages can help attract and retain the best employees. A quick survey of employees about compensation is likely to expose an expectation that wages are fair and cover basic



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living expenses, keep up with inflation, leave some money for savings (perhaps for retirement) and leisure, increment over time.

- A company's compensation scheme also informs a great deal about the firm's values and cultures. Employees often look at what a company pays rather than what it says. In many aspects, people behave as they are rewarded.

## Objectives of Compensation

- ▶ Allure suitable staff.
- ▶ Keep qualified personnel.
- ▶ Develop reward structures that are equitable with logical and fair pay relationships between differently valued jobs.
- ▶ Manage pay structures to mirror inflationary effects.
- ▶ Assure that rewards and salary costs handle changes in market rates or organizational change.
- ▶ Appraise performance, duty, and loyalty, and provide for progression.
- ▶ Abide with legal requirements.
- ▶ Maintain compensation levels and differentials under review and control salary or wage costs.

## WAGES AND SALARY ADMINISTRATION:

- Wage and salary management is related with forming and Implementing system and policy for payment of reward.
- In the wage and salary management aspects deeply and minutely considered are job evaluation, assessment of wage, form a structure of wage, wage incentives, profit share, arrangement of wage etc.
- The main objective of wage and salary administration is to form and maintain a fair structure and subsidiary objective is to form and maintain fair expenditure of labour cost.
- It also aims at providing fair wage structure, motivating the employees and providing satisfaction to the employees.
- Human resource department should be entrusted with the responsibility of wage and salary administration or it should be maintained by expert advisors of general administrative department.
- The problems related to wage and salaries are delicate and for which the solution is derived by high level expert agency.

## Functions:

1. To accept and recommend job evaluation process system and its conclusions.
2. To evaluate and recommend the original structure of wage and salary management.
3. To become helpful in formulating wage policy.
4. To co-ordinate and evaluate wage rates with concerned department.
5. After evaluating the budget, arrange for wage and salary and recommend increments.



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3- Vaishalinagar  
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This committee is run with the help of advice and co-operation of technical staff out of which some of the regional committees conduct surveys in the whole industry for the job evaluation, job description, merit rating, wages and salary and after evaluating the prevailing wage rates, suggests method and process of new wage rates.

## Principles:

1. Keeping in view the necessity of different tasks, there should be separate wage planning for everyone. For it, factors like skill, responsibility, function and work condition, mental and physical requirements should be taken in to consideration.
2. Fair wages should be Close to the prevailing wages in the labour market. Generally, the point of view of labour market should be utilized.
3. The planning should be done keeping in view two separate factors like work and employee. Keeping in mind the requirements of work and factors affecting it, the employee's contribution, his expectations and efficiency should be ascertained.
4. Equal wages for equal work should be equally implemented.
5. Incentives should be paid keeping in view an individual's efficiency and his contribution in the task.
6. There should be a system in which wage related complaints are heard and their effective solutions are brought out.
7. The employees and their unions should be informed in advance about the complete wage planning and administrative process. Everyone should individually be aware about the condition as well as about the structure of wages and salaries.
8. There should be minimum wages so that employees are able to sustain themselves with fair standard of living.
9. Wages and salary administration is changeable. Hence, should be implemented easily. And when the changes are required to be made as per situation, the structure should be made to accept the changes.
10. Bonus, arrears and other financial benefits available to the employees, should be with specific calculation and should be speedily available.
11. The committee reconsiders the wages; always insists on individual justice.
12. Wages and salary should have broadmindedness fulfilling the requirements of employees, in which the requirement of self-achievement is also included. Financial motivation is provided through it, which becomes helpful in enhancing the extent of satisfaction of human element carried out in time.

## Factors affecting wages and salary administration:

1. Capacity to pay wage salary
2. Demand and supply of labour
3. Prevailing market rate
4. Standard of living expense





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5. Sustainable wages
6. Productivity
7. Bargaining power of labour union
8. Job specification and
9. Social and psychological factors.

## Wage structure:

- Many economists have defined wages as economic compensation by the employer to his labourers under contract for services provided by them.
- However, the pay structure of a company depends on many factors. Economists have established various wage theories and wage systems,
- The concepts are (a) Minimum Wage (b) Living Wage (d) Fair wage

### (a) Minimum Wage:

- "It is the one which the employer must pay to his worker without considering his own financial ability.
- "Minimum Wage is the wage which must provide not only for the bare sustenance of life, but for the preservation of efficiency of workers.
- For this purpose, Minimum Wage must provide some measure of education, medical requirements and amenities."
- It is the minimum return that a worker can expect for the services rendered by him. It fulfills basic and safety needs of a worker.

### Minimum Wages is calculated by:

1. The standard working class family should be taken to consist of three consumption units for one earner, the earnings of women, children.
2. The Minimum food requirements should be calculated on the basis of net intake of calories for an average Indian.
3. Clothing requirements should be calculated on the basis of per capita consumption of 18 yards per annum which would give an average worker family of four, a total of 72 yards.
4. In respect of housing, the rent corresponding to minimum area provided for Industrial Housing Scheme by Government for low-income groups.
5. Fuel, Lighting and other miscellaneous items of expenditure should constitute 20 percent of total minimum wage.

### (b). living wage:

- "A living wage is one which should enable the earner to provide for himself and his family not only the bare essentials of food, clothing and shelter but a measure of frugal comfort including education for his children,





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protection against ill-health, requirements of essential social needs and a measure of insurance against the more important Misfortunes including old age."

- This wage provides: 1. Basic of worker 2. Efficiency of worker 3. Satisfy social needs of worker like Medical, Education, retirement etc.

## (c) Fair Wage:

It is the wage, which is higher than the minimum wage but lower than the living wage. According to the Committee on Fair wages, 1948. The following factors are considered while determining the fair wages.

1. The productivity of labour.
2. The employer's capacity to pay.
3. The level of national income and its distribution.
4. The place of industry in the economy of the country.

"A Fair wage is the wage which is above the minimum wage but below the living wage. The lower limit of the fair wage is obviously the minimum wage; the upper limit is to be set by the capacity of the industry to pay." At present, most industries follow the concept of fair wages.

## Methods of Wage Payments:

Different wage systems have been developed in the different countries. Basically there are two methods: time wage method and piece wage method.

### 1. Time wage system:

- In this system wages are paid as per the time of work done by the worker.
- How much work is done by the worker, is not taken into Consideration, but specific time is taken.
- E.g. one hour, one day, One week or month etc. It is considered as a unit and calculation of wages is done on that basis.
- Monthly salary paid to clerk and daily wages paid to workers are such examples.

### The conditions in which this wage system can be favorable are given below:

1. Where the prominence is to be given to quality and not quantity.
2. Where work is to be carried out with precision and care.
3. Where raw material and machinery are costly and maintaining the careful use of machinery and economic use of raw material, it is favourable.



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4. Where the work of one personnel cannot be distinguished from another one. E.g. clerk etc.
5. Where the speed of work is dependent upon machine and not on workers. E.g. milk bottles or other food containers packed on automatic machine.
6. Where the work cannot be calculated in units, e.g. repairing or maintenance work.
7. Where the work is irregularly done or there is frequent interruption in work e.g. supervision of building construction or accountants.
8. Where there is strict supervision system, so that workers do not waste time.
9. Where there are trainees, time wage system can be convenient

## Advantages:

1. Calculation of wages is very simple in this system. By knowing the rate of wage and working time, the amount of wages can be calculated. Even for illiterate workers also, there cannot be any doubt about the calculation.
2. As the workers are paid equally for equal work, their income remains almost the same. Therefore, there is little scope of jealousy amongst, them.
3. As the wages are related to work and not with time, hence workers are not attracted towards doing work in haste, but quality is maintained by working peacefully and preventing wastage.
4. As the wages are paid as per time, unnecessary haste can be avoided and as the work is carried out with concentration, wastage of raw material is prevented. Where there is Costly raw material and where machines are required to be maintained with extra care, this system is welcomed.
5. As the wage rates are already determined, the management can have an idea about the expenses right from the beginning, which becomes helpful in preparing budget and the workers also have the knowledge about their income, so that they can control their expenses.
6. The work in which the exact calculation of output is possible and any other wage system could not be adopted, then time wage system would be convenient to adopt, e.g. work of teacher, clerk or a soldier.
7. In this system, along with maintaining good quality through strict supervision, standard of quantity is also maintained. Moreover, good artisans (workers) can be given high wage standards and encourage him.

## Disadvantages:

1. As all the workers are considered equal in this system efficient and inefficient, idle or hard working, dishonest or honest, difference cannot be demarcated.
2. In this system, supervision on the workers has become very essential because work is not taken into consideration. So it is natural that workers do their work very slowly. So, the supervising expense increases.
3. This system fails to provide necessary encouragement to the workers for showing their best form.
4. As the income of workers is always constant, there is no scope to improve their standard of living. To sustain the family members also becomes very difficult. As the income is not increasing, the workers may get disappointed.



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5. Production in industry never remains constant. As the wages are paid on time basis the rate of wages remains static, average cost per unit of production does not remain constant.
6. In today's competitive times, time wage system seems to be rigid and not flexible.

## 2. Piece-wage system:

- In this system the importance is given to work and not to time.
- The wages are given on the basis of work done by the worker; therefore it is also called payment by result.
- In this system, the units of work and wage rate per unit are decided in advance. Accordingly the number of units manufactured by the worker, the wage rate and the amount of wages can be found out.

**Worker's wages = Units of worker's work \* wage rate per unit.**

In the following situations, this system would prove to be more **favourable**:

1. When the work carried out by the worker can easily be counted, e.g. How many units have the worker manufactured? How many sarees are printed?
2. The skill, concentration and speed of work are useful.
3. Where work is constantly and regularly being done and external factors are not allowed to be entered.
4. Where only one kind of item is manufactured on a machine.

## Advantages:

1. This system recognizes the capacity differentiation of workers. From their work, the capacity of the worker can be assessed and wages are paid according to the capacity. So, the workers get motivation which is proper from both theoretical and practical points of view.
2. In this system the wage rate is based on the worker's work, therefore, workers are naturally motivated to work more. Workers would work with enthusiasm to get more wages. Consequently, productivity and production, both would increase its advantage would be available to the Whole system.
3. The supervision expense can be avoided in piece wage because once the guidance is provided to the worker he himself would start working in earnest.
4. As the wages are paid according to work, an estimate can be made about the labour cost. It helps in deciding the production cost, which makes it possible to formulate the price policy
5. This system proves considerably useful to the workers in earning their livelihood sufficiently. Expert, efficient and enthusiast workers get the opportunity to improve their standard of living.
6. Workers would take extra care to maintain the machinery, because if the machines stop, then its direct effect would be on their work and work's effect would be on wages. Hence, the workers would be constantly trying to see that machines work smoothly for a longer period of time.



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**Ph. No–(0281)2471645**

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**Ph.No–(0281)2440478, 2472590**

7. The workers would be enthusiastically finding out new and Speedy work system. Progressive manufacturers recognise their abilities, because speedy systems would increase more production.
8. As in this system the workers get wages as per their work they would be loyal to the firm with consistency. That means labour turnover would reduce. Consequently, industrial peace would be maintained.
9. Workers can easily carry out the calculation of their wages, because the units of work would be known to them, only they have to know wage rate, so that they can precisely calculate their wages.

### **Disadvantages:**

1. As the workers get wages as per the quantum of work under this system, the worker tries to do more and more work and doing so they may forget about quality of the product.
2. Enticed by more work more wages, the workers may pull the work beyond their capacity and invite harm to their physique.
3. In getting more production of workers careless use of raw material would invite wastage and more usage of automatic machines can be done.
4. For getting more production the workers may invite accidents. There is every possibility of ignoring security measures.
5. In this system, the workers get wages per work and it is obvious that all the workers do not have equal ability and every one of them would not get the equal wages. This leads to jealousy among the workers. Consequently, the unity of Workers is endangered.
6. This system cannot sustain, where skill is required in doing work and where only illiterate labours are required, this system cannot work. Hence, the use of this system remains limited.
7. In this system as the wages are paid on the basis of work done, noting down the work, registers are required to be maintained. So the official work increases. Thus this system proves to be very expensive.
8. In this system as there is no guaranty of minimum wages, new, learning and inexperienced workers get very less wages.
9. In those production processes where standard unit cannot be determined, how much wages can be suggested?
10. By keeping the standard unit high or wages low, the proprietors can exploit the workers and the outcome of exploitation is well known to all. It creates inequality of classes and clash of classes and ultimately industrial peace is disturbed.

### **DIFFERENCE BETWEEN TIME WAGE SYSTEM AND PIECE WAGE SYSTEM:**

<b>TIME WAGE SYSTEM</b>	<b>PIECE WAGE SYSTEM</b>
1. Wages are paid as to how much time (hours or days) a worker has done his	In the piece wage system the quantum of work is considered for payment of wages.



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work.	
2. In the payment of wages the quantum of work is ignored.	In the payment of wages, element of time is ignored.
3. Minimum wage guarantee is given. It is assured that fixed wages would be paid.	There is no guarantee of minimum wage. It is not assured of fixed wages.
4. As the payment of wages is fixed, the company can have the estimates about the payment of wages.	As the payment of wages is not fixed, it becomes difficult to get the estimates of payment of wages.
5. Unit wise production cost of labour is different because workers do not manufacture product in specified quantity and time.	Unit wise production cost of labour is uniform because the payment is made piece wise.
6. It is convenient for new workers, as in the initial period, their output is less, but they have the assurance of fixed wages.	New workers give less output in the initial period, so they get less wages. It is not convenient for new workers.
7. All the workers get same wages, so there is no possibility of jealousy among them.	Wages paid to all the workers may be different. So, naturally there is jealousy among them.
8. This wage system lacks the encouragement. It does not attract efficient workers	This wage system has the element of encouragement. Workers can earn as per their efficiency.
9. Where the payment of wages is to be made on the time wage system, strict supervision system is required to be maintained.	There is no need of strict supervision system. If they waste time or reduce the output, then accordingly, they would get less wages.
10. Labour unions favour this wage system.	Labour unions do not favour this wage system.
11. Where the work cannot be directly valued into money, time wage system is convenient, e.g. education.	Where the specific measure of produced units can be calculated and the output can be measured in terms of money, this system can



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	be implemented, e.g. manufacturing boxes, papad etc.
12. The work in which not the production but quality plays important role, time wage system can be convenient to it. E.g. research work.	Where not the quality but total production has significance, piece wage system can be implemented. E.g. filling in match boxes, cleaning bottles etc.
13. Where the payment of wages is done as per time wage system, workers carry out their work patiently, because they are assured about their wages. So the wastage of raw material is less. They do not make unnecessary haste. Hence, there is optimum usage of machinery.	Worker may waste the raw material in order to do more work and earn more money. They may increase the speed and would have heavy usage of the machinery and sometimes they may invite industrial accident also. Hence, they go for more earning at the cost of their health and safety.

## JOB EVALUATION :

- Job evaluation is the outcome of job analysis. While job analysis describes the duties of the job, authority responsibility relationships, skills required, conditions of work, and other relevant information, job evaluation uses the information produced by job analysis to evaluate each job which means determining the relative worth of a job by valuing its different components.
- In short, it can be called as the process of measuring value of jobs in an organisation
- It helps the management in maintaining high levels of employee productivity and satisfaction
- If these job values are not ascertained properly, jobs would not be appropriately priced, i.e., highly valued jobs may receive less pay than low valuable jobs
- This would create dissatisfaction among the employees and they may leave the jobs or may not perform their jobs effectively

## **Objectives of Job evaluation**

- To secure and maintain complete description of each job in the organisation
- To provide a standard procedure for determining the relative value of each job in the organisation
- To determine a fair rate of salary/ compensation for each job in relation to other jobs in the industry
- To ensure same wages / compensation is paid to all qualified employees who are involved in doing similar work





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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- To promote and provide a factual basis for consideration of wage rates for similar jobs in the industry
- To provide information for each employee selection, placement, training and other similar areas

## Advantages – Job evaluation

- It is logical and objective method of ranking jobs in relation to one another
- It removes inequalities existing in the wage structure and in maintaining sound and consistent wage differentiation in an Organisation
- In case of new jobs, job evaluation data helps the organisation to find out the monetary value of the new job
- It results into equal payments to the jobs having same value and different payments two jobs having different value ensuring fair wages
- Improve employer employee relations
- Justify differences in wages and salaries being paid to employees
- Simplify the Wage and salary administration as the values are pre-determined and wages are paid accordingly
- The information collected can be used for improvement of selection, transfer and promotion procedures
- Defines monetary value of the job ensuring wages are determined in accordance with the efficiency required to perform the job and also ensuring that efficient people are not underpaid and inefficient are not overpaid

## Disadvantages

- Human bias cannot be eliminated completely from any job evaluation method even if efforts are made to make it systematic. The element of human judgement is present in all the methods of job evaluation.
- The factors considered for job evaluation sometimes overlap. The weightage given to them and their reliability becomes questionable.
- Job evaluation will have to be done regularly because the factors considered for it today may not remain valid tomorrow because of technological changes.
- There are apprehensions among workmen when job evaluation is introduced for the first time. It may create doubts in the minds of those whose jobs are evaluated.
- Job evaluation programme requires lot of time and specialised technical personnel.
- The introduction of job evaluation scheme may require substantial changes in the existing set up. This change may involve appreciable costs and the concern may not be able to bear this financial burden.
- This system is suitable to big concerns only because it is very expensive.
- The trade unions consider it as an encroachment on their right to negotiate for wage structure.
- This system causes inflexibility. The demand and supply of labour is the main cause for wage differentials.





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- There may be a conflict about the factors to be chosen for job evaluation. Workers insist on the inclusion of some factors which they feel favourable to them.

## METHODS OF JOB EVALUATION

### 1. The Ranking Method

- Under the system, all the jobs are arranged or ranked in the order of their importance from the simplest to the hardest or in the reverse order, each successive job being higher or lower than the previous one in the sequence.
- Although job descriptions might be useful, it is not necessary to do it
- A more common practice is to arrange all the jobs according to the requirements by rating them and establishing groups or classification
- An example of Pharma Company's sales job ranking could be:
  - Marketing manager
  - Regional marketing manager
  - Area sales manager
  - Medical representative
- In a University system, it may be professor, associate professor and assistant professor
- After ranking additional jobs between those already ranked, an appropriate wage rate/ compensation is assigned
- There are five steps involved in the system:
  - Preparation of job description
  - Selection of raters
  - Selection of rates and key jobs
  - Ranking of all jobs
  - Preparation of job classification
- The ranking system of job evaluation usually measures each job in comparison with other jobs in terms of their relative importance of the following factors:
  - Supervision and leadership of subordinates
  - Cooperation with the associates outside the line of authority
  - Minimum experience requirement
  - Minimum educational qualification required
  - Probability and consequences of errors in terms of waste, delays, complaints, confusions, spoilage, damage etc.

### Merits – Ranking system

- Simple, easy to understand and explain



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- Suitable for small organizations
- Less expensive
- Minimum maintenance
- Requires less time, fewer forms and less work

## Demerits – Ranking system

- No standard for analysis
- Based on judgment and can be influential
- All jobs not analyzed separately
- Importance of job is ignored and only rank is known
- New job would change the entire sequence

## 2. Job classification or Grading method

- Under the system, a number of predetermined grades are first established by a committee and then various jobs are assigned within each grade or class
- Grade descriptions are a result of basic job information which is usually derived from job analysis
- After formulating and studying job description and job specification, jobs are grouped into classes or grades which represent different pay level ranging from low to high. Common job responsibilities, knowledge and experience can be identified by the process of job analysis
- Certain jobs may then be grouped together into a common grade and classification
- General grade descriptions are written for each job classification and finally they are used as standards for assigning all the other jobs to a particular pay scale
- The following steps are generally involved:
  - a. Preparation of job description
  - b. Preparation of grade description
  - c. Selection of grades and key jobs
  - d. Grading of key jobs
  - e. Classification of all jobs

## Merits – Grading method

- Simple to operate and understand as it does not take much time and does not even require Technical help
- Since oral job descriptions are used, the evaluation of jobs tends to be more accurate as compared to the ranking system
- It is used in government services and operate efficiently but not very commonly used in industry. Indian Railways uses this method of job evaluation
- The grouping of jobs makes salary determination problems administratively easier to handle



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- Salary grades are determined for all job classification

## Demerits – Grading method

- Although it is more accurate than the ranking system, it depends on the personal evaluations made by a supervisor or a rater
- This system is rigid and an unsuitable for large organisations having variety of jobs
- It is difficult to know how much of a job's grade is influenced by the man on this job
- Job classification is in general terms and hence only overall assessment is possible for valuing a job

## 3. The Point System

Sr. No.	Factor				
1	<b>Education</b>	Post Graduate (05)	Graduate (04)	High School (03)	Primary (02)
2	<b>Experience</b>	2 years (05)	1 year (04)	6 months (03)	Fresher (02)
3	<b>Mental Effort</b>	Very high (05)	High (03)	Average (02)	
4	<b>Complexity of job</b>	Very high (05)	High (03)	Average (02)	

- This method is the most widely used job evaluation technique
- It requires identifying a number of characteristics of the job and different points are assigned to these different factors or characteristics
- Factors like skill, education, experience etc. that are required in a job are identified and then predetermined assigned to each of them

## Merits – Point system

- Give the organisation a numerical base for measuring the value of a job
- Once the point scales are developed they can be used for a longer period of time and this method can be used even when some job changes like promotion and transfer occur
- Prejudice and human judgement are minimised and hence manipulation may not be possible



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- ❖ It has the ability of handling large number of jobs and enjoy stability as long as the factors identified remain relevant
- ❖ The worker's acceptance of the system is very high because it is more systematic and objective than other methods

## Demerits – Point system

- The development and installation of this method calls for a very heavy expenditure
- The task of defining different job factors for all jobs is very time consuming and difficult
- It is a complex method which requires a skilled personnel and sometimes workers do not fully understand this method of evaluating jobs
- IT increases work since it involves recording work of all job factors during evaluation

## 4. Factor Comparison method

- Under the system, jobs are evaluated by means of a standard yardstick of value
- It includes deciding which jobs have more of certain factors as compared to other jobs
- Here the evaluation committee selects some key job for which clearly understood job description and salary rates are agreed upon and are acceptable to management and workers Union
- Each job is ranked several times- once for each factor selected
- ex.: Jobs may be ranked first in terms of the factor 'skill' and then 'education' and then 'experience'
- Finally this individual ratings are combined for each job and the overall evaluation is prepared

Factor (Job rating)	Mental skills	Responsibility	Education	Experience
A	A	D	C	E
B	B	A	D	A
C	C	B	A	C
D	D	E	B	D
E	E	C	E	B

Job Factors	Job A	Job B	Job C	Job D	Job E
Concentration	300	175	150	100	50
Responsibility	200	130	75	275	100
Education	175	150	300	200	80
Experience	200	50	160	120	300
Total	875	505	685	695	530

## Steps in this method

- Clear cut job descriptions and specifications are developed
- Selection of key jobs which are most important in the organisation
- Ranking of K jobs on the basis of factors like mental concentration, experience, education, responsibility, skills required etc.
- Valuing the factors which involves determining the basic pay for each of the key jobs distributed
- Establishing the monetary value for all the jobs



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## Merits – factor comparison

- Systematic quantifiable method
- Jobs are compared to other jobs to determine relative value
- It is fairly easy system to explain to the employees and their unions
- Scientific method with greater validity and reliability
- An objective method and there is minimum chance of personal bias

## Demerits – factor comparison

- Costly to install and difficult to operate for anyone who is not acquainted with general nature of job evaluation techniques
- Complex system for employees performing routine or lower level jobs
- Wage levels change from time to time and these minor changes have to be adjusted to all jobs

## WAGE SYSTEMS/METHODS OF WAGE PAYMENTS:

### Time wage system

- This is the oldest method of wage payment. “Time” is made a basis for determining wages of worker. Under this system, the wages are paid according to the time spent by workers irrespective of his output of work done. The wage rates are fixed for an hour, a day, week, a month or even a year (seldom used).
- For example, a wage rate of Rs. 70 per day is fixed in an industrial unit. Two workers A and B attend work for 28 and 16 days respectively. The wages as per time wage system will be Rs. 1960 and 1120 for A and B respectively. This method of wage payment does not give weightage to the quantity of goods produced by the workers.
- The supervisor may ensure that workers do not waste their time and the quality of goods is also maintained. There are no hard and fast rules for fixing rates of wages. These may be decided according to the level of the past higher positions may be paid higher rates and vice- versa.
- **Wages are calculated in the method as follows:**
- $Earnings = T \times R$  where T stands for time spent and R is rate of pay.

### Suitability:

#### Time wage system is suitable under following situations:

- When productivity of an employee cannot be measured precisely.
- Where quality of products is more important than the quantity produced.
- Where individual employees do not have any control over production.
- Where close supervision of work is possible.
- Where work delays are frequent and beyond the control of workers.



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## Conditions in which time wage system is suitable

- Where the prominence is to be given to quality and not quantity
- Where work is to be carried out with Precision and care
- Where raw material and machinery are costly and it is important to maintain the careful use of machinery and economic use of raw material
- Where the work of one personal cannot be distinguished from another one. Example: Clerk
- Where the speed of work is dependent upon machine and not an workers
- Where the work cannot be calculated in units
- Where the work is irregularly done or there is frequent interruption and work
- Where there is a strict supervision system so that workers Do not waste time
- Where there are trainees time wage system can be convenient

## Advantages

- Simple
- Equal payments
- Sense of unity
- Workers don't work in haste
- Prevents wastage
- Maintenance of machinery and raw materials
- Mgt has idea of expenses from beginning
- Exact calculation possible
- Standard of quantity also maintained

## Disadvantages

- Differences between honest and dishonest worker not identified
- Workers do their work very slowly
- Lack of encouragement
- No scope of improvement in standard of living
- Rigid and not flexible as per situation

## Piece Wage System

- Importance given to work and not to time
  - There is no consideration for time taken in completing a task.
  - A fixed rate is paid for each unit produced, job completed or an operation performed.
  - Workers are not guaranteed minimum wages under this system of wage payment.
  - Worker's wages = Units of worker's work x wage rate per unit
- Different piece rates will be determined for separate jobs.



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- The factors like efforts involved, conditions under which work is to be performed, risk involved, etc. should also be taken into consideration while fixing piece rates.
- The piece rate should be reviewed from time to time.
- Piece rates should also be revised when competitors do so otherwise there may be a discontentment among workers and they may opt for changing in the unit/enterprise.

## Advantages

- Capacity differentiation & motivation of workers
- Less supervision needed
- Helps improve standard of living
- Extra care of everything
- Industrial development becomes speedy
- Loyalty of workers
- Workers can calculate the wages themselves as well

## Disadvantages

- Faulty works can be found
- Workers work beyond their capacity to earn
- Wastage possible
- Jealousy factor
- Limited system, cant be used everywhere
- No guarantee of minimum wages
- Exploitation of workers

## Comparative study

	TIME WAGE SYSTEM	PIECE WAGE SYSTEM
1	Wages are paid as per how much time a worker has worked	The quantum of work is considered for payment of wages
2	Element of quantum of work is ignored	Element of time is ignored
3	Minimum wage guarantee is given	No assurance of minimum wages
4	Company can have estimates about the	Difficult to estimate the payment





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	payment	
5	Unit wise production cost of labour is different	Unit wise production cost of labour is same because the payment is made piece wise
6	Convenient for new workers	Not convenient for new workers
7	No possibility of jealousy	Jealousy among workers
8	Lacks encouragement	Has an element of encouragement
9	Strict supervision is required	No need for strict supervision
10	Labor union favors	Labor union do not favor
11	Where work cant be directly valued to money, it is suitable	When output can be directly valued to money, it is suitable
12	Not production but quality plays an important role	Here production play important role



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# PERSONALITY DEVELOPMENT & COMMUNICATION SKILL

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### UNIT : 1 ENGLISH AND SOFT SKILLS

#### ➤ LISTENING SKILL :

##### ○ What Is Listening?

- Listening is the ability to accurately receive and interpret messages in the communication process.
- Listening is key to all effective communication, without the ability to listen effectively messages are easily misunderstood.
- Listening is one of the most important skills you can have.
- An active process of getting information, ideas.
- **“Listening is the process of receiving, constructing meaning from, and responding to spoken.**
- • Listening is not just about being Quiet while someone else is speaking.
- Listening is with the Mind. • Hearing with the senses.
- Listening is conscious.
- To improve our interpersonal & oral exchange.
- Just Listening to words is not enough; a good Listener has to pay attention to the non-verbal communication of the speaker.

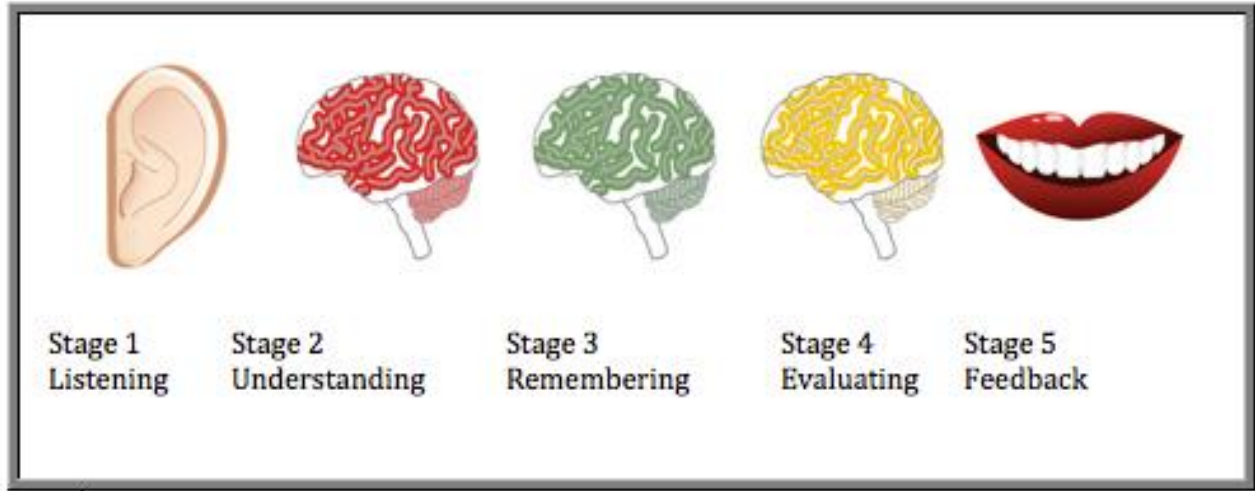


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### 1- Receiving

- Is the intentional focus on hearing a speaker's message.
- This stage is represented by the ear because it is the primary tool involved with this stage of the listening process.

### 2- Understanding :

- In the understanding stage, we attempt to learn the meaning of the message, which is not always easy.
- Deciding what the message means to you

### 3- Remembering:

- Remembering begins with listening; if you can't remember something that was said, you might not have been listening effectively.
- However, even when you are listening attentively, some messages are more difficult than others to understand and remember.
- Highly complex messages that are filled with detail call for highly developed listening skills.

### 4- Evaluating :

- The fourth stage in the listening process is evaluating.
- evaluations of the same message can vary widely from one listener to another.
- The stages two, three, and four are represented by the brain because it is the primary tool involved with these stages of the listening process.

### 5- Responding :

- Responding—sometimes referred to as feedback—is the fifth and final stage of the listening process.
- Your reaction to the message. It can be emotional and intellectual



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- For example, you are giving positive feedback to your instructor if at the end of class you stay behind to finish a sentence in your notes or approach the instructor to ask for clarification.
- The opposite kind of feedback is given by students who gather their belongings and rush out the door as soon as class is over.
- This stage is represented by the lips because we often give feedback in the form of verbal feedback; however, you can just as easily respond nonverbally.

### ➤ Importance of Listening

- We show that we are serious
- We display respect to other's view point
- Helps us to learn
- Helps us to adapt and understand
- Empathize

### ➤ Why Listening is Important?

- To avoid communication errors.
- Helps to learn something new.
- It is the key to success.

### Basic Types of Listening

- Active listening
- Selective listening
- Emphatic listening
- Ignoring listening

#### 1/ Active Listening :

- Understanding all things
- Proper interaction.
- Proper feedback

#### 2/ Selective Listening :



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- We remember only
- Selective portion.
- Topic is not to our liking

### 3/ Empathetic listening :

- When we listen empathetically, we go beyond sympathy to seek a truer understand how others are feeling.
- This requires excellent discrimination and close attention to the nuances of emotional signals.
- When we are being truly empathetic, we actually feel what they are feeling.

### 4/ Ignoring Listening :

- Not listening at all
- Is pretty insulting to others.
- It can lead to strained relations

#### ➤ Can you hear me ?

- Does that mean that you are a good listener?
- A person with normal hearing is not necessarily a good listener.
- Many different things can prevent a speaker's message from being received...
- These are called barriers to listening.

#### ➤ Barriers to effective listening :

Some common barriers in the process of listening are listed below.

- 1.) Pre-judgments about the speaker .
- 2.) Assuming that the speaker is going to give some unimportant information .
- 3.) Arriving late for a speech, presentation or lecture .
- 4.) Judging the speaker by his/her mannerisms, voice, appearance, accent, etc.
- 5.) Lack of concentration/interest .
- 6.) Avoiding listening to difficult, boring or complex information and selectively listening only to what is considered interesting.
- 7.) Speaker or listener being distracted by disturbances .





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### ➤ How To Listen Effectively?:

1. Stop Talking – Be Silent
2. Show Interest
3. Empathize
4. Ask Questions
5. Maintain Eye Contact
6. Take notes
7. Listen Creatively
8. Put Your Entirety
9. Send feedback
10. Avoid or eliminate distraction
11. Try to gather information about the topic to develop interest and familiarity.

### ➤ Benefits of Effective Listening :

- Enhances productivity
- Improves relations
- Avoids conflicts
- Improves understanding
- Improves negotiation skills
- Adds to your Image & Personality

### ➤ TEAMWORK SKILL :

#### ✓ What are teamwork skills ?

Working well in a team means:

- Working with a group of people to achieve a shared goal or outcome in an effective way
- Listening to other members of the team
- Taking everyone's ideas on board, not just your own



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- Working for the good of the group as a whole
- Having a say and sharing responsibility

A successful team is one where everyone's unique skills and strengths help the team achieve a shared goal in the most effective way.

If you have good people skills you'll make a good team player, and skills like communication and having a positive attitude make a team great

### ✓ Teamwork is one of the 5 top young professional skills:

The 5 top life skills are [self belief](#), [communication](#), [self management](#), [teamwork](#) and [problem solving](#). Employers love them and so will you. They could change your life! Whatever your interests and background are, sign up to the weekly Young Professional newsletter and start boosting these skills for free today.

### ✓ Why are the teamwork skills important? :

- Teamwork is vital if you want to work well with colleagues and teammates.
- You will probably have to work as part of a team in many areas of life; from class projects to planning a birthday party.
- The better you work with others, the more successful your team will be in achieving their goals.
- Employees often need to collaborate or work with others to complete tasks and projects – having teamwork skills and experience will make it a much better experience.
- Even if you work well on your own, using key life skills like self management, being a team player is a valued skill for most jobs.

### ✓ Teamwork skills in work:

- Most forms of work with more than one employee involve you working as a team.



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- Team working is a bit more complicated than just being in a group of people getting things done.
- The difference between a good and a bad team is how well they work together.
- Your team work skills can help you at work in all sorts of ways.
- Perhaps you're working as a team on a construction project where thinking about the health and safety of yourself and your team mates is vital.
- Maybe you need to pull together as a team to create a monthly report for a client to a tight deadline.
- Team work also helps gets things done when you're planning a birthday party for someone you work with!
- Having teamwork skills will make it a much better experience for everyone, whether you are working long hours or trying to choose which cake to buy.
- You've probably worked as part of a team in the past, so try to think about what went well and what didn't

### ✓ Building teamwork skills at work will help you:

- Achieve the desired results for a project in a quick and positive way
- Improve your communication skills, e.g. listening, taking instruction and offering support and ideas

Good team working skills will give you more chances to move forward in your career, too. People can see you as someone with a positive attitude who thinks the company's goals are important. An attitude like this can help you get more opportunities, responsibility, training and promotions over time.

### ✓ How to build and improve teamwork skills:

A great way to build your team work skills is to volunteer for any team projects and say to yourself "we can do this together."

### ✓ Ways to develop teamwork skills:

- Create a project



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Ph. No–(0281)2471645

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Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
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Find opportunities to work in a group. Then make sure you contribute to the group and help others to get involved.

- **Join a local group**

Lots of groups run in local areas for all kinds of interests including conservation, politics, special interests and team sports. Getting involved in a group is a great way to build your teamwork skills.

- **Understand how to work in a team**

Communication, planning, problem solving and negotiating are some of the skills you will need to develop. Work on these skills and your teamwork skills will improve too!

- ✓ **Teamwork is a life skill. You can grow it over time.**

There are so many chances in life to do something as part of a group, both inside and outside of work/education.

### **ASSERTIVE SKILL:**

- ABSTRACT: Assertive communication is the ability to speak and interact in a manner that
- considers and respects the rights and opinions of others while also standing up for your own rights,
- needs and personal boundaries. Assertive communication skills create opportunities for open
- discussion with a variety of opinions, needs and choices to be respectfully heard and considered in
- order to achieve a win-win solution to certain problems. It can strengthen your relationships,
- reducing stress from conflict and providing you with social support when facing difficult times.
- 
- **Key words:** ability, assertiveness, assertive behavior, passive behavior, aggressive behavior.

- ✓ **Introduction**



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- People communicate with each other both verbally and nonverbally.
- We transmit our thoughts and feelings through words - verbal and nonverbal through body language, tone of voice, facial expressions, gestures and actions.
- It is important to have an agreement between the two forms of communication.
- Studies show that when there is a discrepancy between verbal and nonverbal message we tend to believe the second one.
- Starting from the two forms of communication are three styles of communication in relationships.
- These styles are called passive, aggressive and assertive.
- It is known that people use all three styles of communication in a conversation and when the
- situation requires they address only one style.
- "Assertive" is a new term, introduced somewhat abused in Romanian, with an uncertain status of neologism which refers to an assertive person, ambitious, who wants to impose, self-
- controlled.

### ✓ What does it mean to be assertive?

- It means you can say what you do not agree with in an elegant manner, without being
- verbally aggressive, without damaging or disturbing, without being placed in a delicate position,
- leaving room for discussion, but in terms that you took the freedom to "**impose.**"
- We are often at home, at work, in society, faced to relate with people who do not
- communicate as we want, that don't understand the words we say.
- This inability to communicate leads to frustration, disappointment and sometimes creates a feeling of powerlessness.
- From there to shouting, to raise the tone or use harsher words, there is only one step.
- Those who have experienced some kind of education may not fall into this "sin", using different ways to express dissatisfaction, disagreement or even control the discussion.



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- But what happens to "others"? Well, the others get to say words that they regret later, come across to channel frustration in the form of verbal aggression, often directed towards people nearby that are not necessarily involved directly in the events referred to in the discussion.
- ✓ **What is assertiveness ? :**
  - Assertiveness is the ability to represent to the world what you really are, to express what you
  - feel, when you feel it necessary.
  - It is the ability to express your feelings and your rights, respecting the feelings and rights of others.
  - Those who have mastered assertiveness are able to reduce interpersonal conflicts in their lives, thus removing a major source of stress for many of us.
  - Assertive behavior demonstrates respect for self and others, promotes self-disclosure, self-control and positive appreciation of self-worth.
  - Assertiveness is the most effective way of solving interpersonal problems.
  - Direct communication, openness and honesty allow you to receive messages without distortion, which maintains relations with others.
- ✓ **Understandings of assertiveness :**
  - **Lazarus (1973)** was the first to identify specific classes of responses in which assertive behavior can be defined: "the ability to say no, the ability to ask favors or make requests, ability to express positive and negative feelings, the ability to initiate, continue and finish a general conversation."
  - **Smith (1975)** analysis assertive behavior as a fundamental right of every individual. His



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concept of freedom has taken a much more extensive liberty than the social-democratic philosophy

had: "You have the right to judge your own behavior, thoughts and emotions, to have responsibility

for taking behaviors and their consequences."

- **Lange and Jacobowski (1976) claimed that** "assertiveness involves personal rights and

expressing thoughts, feelings and beliefs directly, honestly and appropriately, without violating the rights of others".

- **The most successful definition of this category is made by Rimm and Masters (1979):**

"Assertive behavior is an interpersonal behavior involving relatively honest and direct expression of

thoughts and feelings that are socially appropriate and take into account the feelings and welfare of other people".

- **Some definitions are attached to the emotional exposure as a key. :**

**Wolfe (1982)** conceptualizes assertiveness as "expressing any emotion other than a person's anxiety."

Lowrence (1997) extends the concept of assertiveness to "learning ability to adapt behavior to interpersonal situation on demands so that positive consequences are best and negative one - minimum."

### ✓ Assertive style :

- Assertive communication style is a combination of passive and aggressive style.
- This style also requires fairness and power.





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- This characterizes people fighting for their rights but assertive while remaining sensitive to the rights of others and so the fight for what they deserve will not harm anyone.
- These are people that are relaxed and talk openly about their feelings.
- Assertive style of communication requires a balance between what these people want and what others want.
- The basis of this communication style is open attitude towards oneself and others, and hearing other points of view and respect for others.
- This communication style is best suited for a good long term relationship.
- Studies show that people who deal in an assertive style of communication are able to reach an emotional welfare.
- This communication style allows you to argue your opinion without being aggressive and not feel humiliated.

### ✓ Components of assertiveness:

- **The behavioral component of assertiveness includes a series of non-verbal elements such as:**

1. **Eye contact:** an assertive person will look their interlocutor in the eye. Lack of eye contact can send unwanted messages, such as: "I'm not sure what to say" or "I am very afraid";
2. **Tone of voice:** even the most assertive message will lose its significance if it is expressed with a hushed voice (this will give the impression of uncertainty) or too hard, which could activate depressive behavior on the interlocutor;
3. **Stance:** assertive posture of a person varies from situation to situation. However, it is estimated that in most cases, the subject must stand right: not too stiff,



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because it expresses a state of tension, not too relaxed, because others could interpret such a position as disrespectful.

4. **Facial expressions:** for the message to be assertive naturally, mimicry must be appropriate and congruent with the message content. Otherwise, for example, if someone smiles when he says that something bothers him, the party offers ambiguous information, which alters the meaning of communication.
5. **Timing the message:** the most effective assertive message loses meaning when taken in the wrong time. Thus, for example, no boss will respond favorably to a request for wage increase, no matter how well made is that made, if an employee approaches you when preparing to appear before a committee of the company's control.
6. **Content:** even if all other conditions are met, the message does not achieve its purpose if it is too aggressive, with the intention of blaming the other or, conversely, expressed in a very shy and passive way. The content of an assertive message should be narrowly, descriptive and direct.

✓ **Highlight other person's behavior :**

- One thing that works when we have a confrontation with someone is trying to emphasize the disturbing behavior of other people, for example to say: "Why raise your voice at me?".
- The question will be confusing at the moment and it will make him/her lose the thread of thought and to think about his/hers actions.
- Some people just do not realize when they become aggressive in conversation, and this is a great way to take control in a situation like this.

✓ **Five simple steps to assertive behavior**



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1. When you approach someone about a behavior change that you want to see in that person, make reference to factual descriptions of the thing that has upset you, and do not affix labels or value judgments.
2. The same thing is true when describing the effects of behavior. Do not exaggerate and do not judge, just describe! Do not say "You ruined my hole night", but said: "We have less time available to discuss the issue, because to 18.30 I planned something else."
3. Use the word "I". You'll succeed as to focus on what you feel and how you are affected by the behavior of others. If you start with "You", that phrase would be perceived as an attack and the other will maintain the conflict. Do not say: "You must stop!" but, "I would feel better if you did not do that."
4. Here's a formula for success in assertive communication: "When you [the other's behavior], I feel [my feelings]." "When you scream, I feel attacked."
5. A slightly more comprehensive formula for such situations is: "When you [the other's behavior], then [the result of conduct], and I feel [my feelings]." "When you tell the children they can do something I've banned them, then my parent's authority is affected and I feel discredited before them. "



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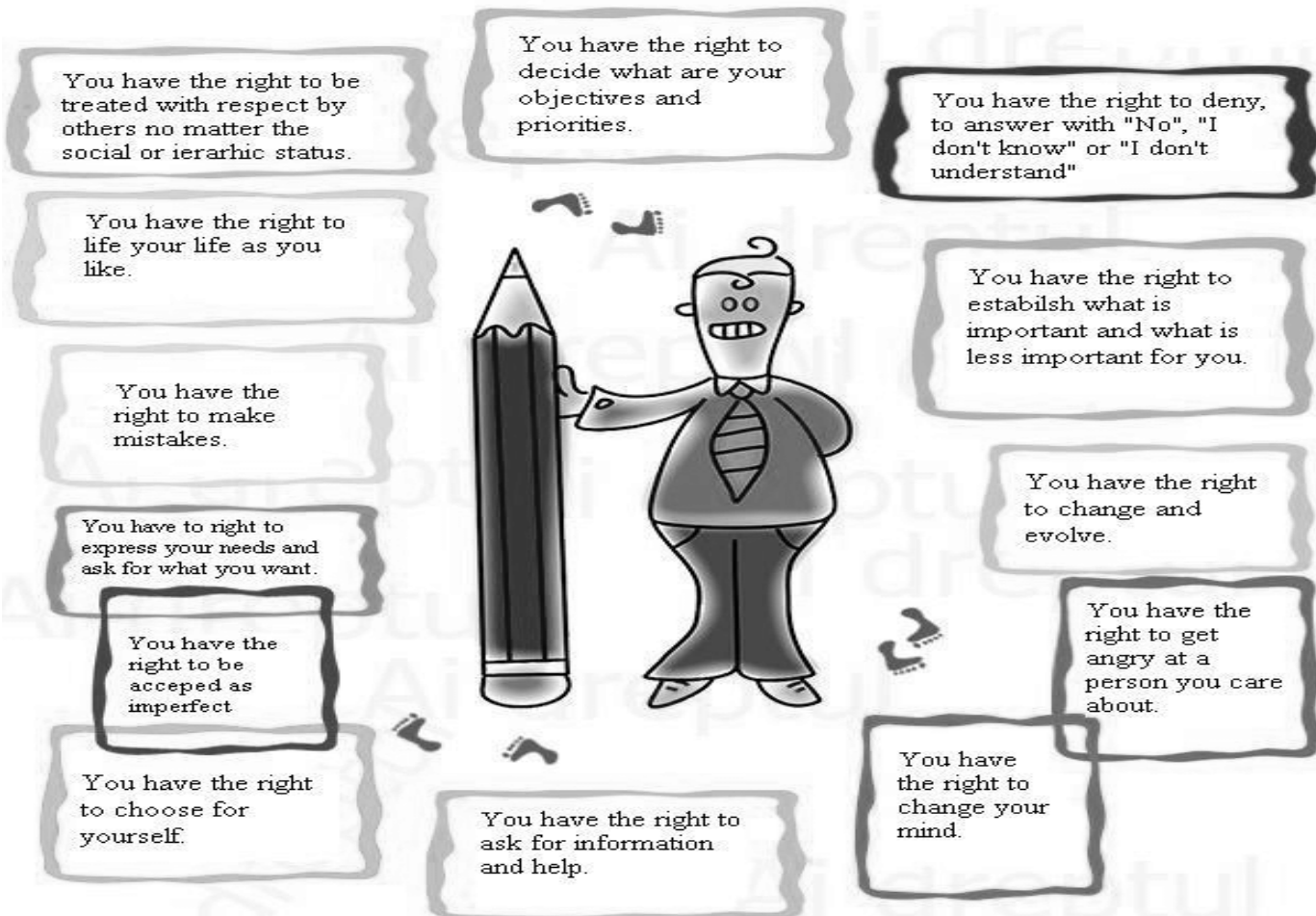
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### THE RIGHT TO ASSERTIVENESS

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#### ➤ PROBLEM SOLVING SKILL :

#### ✓ INTRODUCTION:

When employers talk about problem-solving skills, they are often referring to the ability to handle difficult or unexpected situations in the workplace as well as complex business challenges. Organisations rely on people who can assess both kinds of situations and calmly



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Ph. No–(0281)2471645

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identify solutions. Problem-solving skills are traits that enable you to do that. While problem-solving skills are valued by employers, they are also highly useful in other areas of life like relationship building and day-to-day decision making.

1. What are problem-solving skills?
2. Examples of problem-solving skills
3. How to improve your problem-solving skills
4. How to highlight problem-solving skills

### ✓ What are problem-solving skills?

Problem-solving skills help you determine the source of a problem and find an effective solution. Although problem-solving is often identified as its own separate skill, there are other related skills that contribute to this ability.

#### **Some key problem-solving skills include:**

- Active listening
- Analysis
- Research
- Creativity
- Communication
- Dependability
- Decision making
- Team-building

Problem-solving skills are important in every career at every level. As a result, effective problem solving may also require industry or job-specific technical skills. For example, a registered nurse will need active listening and communication skills when interacting with patients but will also need effective technical knowledge related to diseases and medications. In many cases, a nurse will need to know when to consult a doctor regarding a patient's medical needs as part of the solution.



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### ✓ Examples of problem-solving skills :

To solve a problem effectively, you will likely use a few different skills. Here are a few examples of skills you may use when solving a problem.

- **Research**

Researching is an essential skill related to problem solving. As a problem solver, you need to be able to identify the cause of the issue and understand it fully. You can begin to gather more information about a problem by brainstorming with other team members, consulting more experienced colleagues or acquiring knowledge through online research or courses.

- **Analysis**

The first step to solving any problem is to analyse the situation. Your analytical skills will help you understand problems and effectively develop solutions. You will also need analytical skills during research to help distinguish between effective and ineffective solutions.

- **Decision-making**

Ultimately, you will need to make a decision about how to solve problems that arise. At times (and with industry experience), you may be able to make a decision quickly. Solid research and analytical skills can help those who have less experience in their field. There may also be times when it is appropriate to take some time to craft a solution or escalate the issue to someone more capable of solving it.

- **Communication**

When identifying possible solutions, you will need to know how to communicate the problem to others. You will also need to know what communication channels are the most appropriate when seeking assistance. Once you find a solution, communicating it clearly will help reduce any confusion and make implementing a solution easier.





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- **Dependability**

Dependability is one of the most important skills for problem-solvers. Solving problems in a timely manner is essential. Employers highly value individuals they can trust to both identify and then implement solutions as fast and effectively as possible.

- ✓ **How to improve your problem-solving skills**

There are several methods you can use to improve your problem-solving skills. Whether you are searching for a job or currently working, improving your problem-solving skills and associated abilities will help make you a strong candidate and employee.

- **Acquire more technical knowledge in your field.** Depending on your industry, it may be easier to solve problems if you have a strong working technical knowledge. You can gain more technical knowledge through additional coursework, training or practice.
- **Seek out opportunities to solve problems.** By putting yourself into new situations, you are more likely to be exposed to opportunities to solve problems. You may find there are opportunities to volunteer for new projects in your current role, on another team or outside the workplace for another organisation.
- **Do practice problems.** Practice and role-play can be useful tools when learning to develop your problem-solving skills. You can find professional practice books for your industry and problem-solving scenarios online. Practice how you might solve those problems and determine if your potential solutions are viable.

For example, in customer service, you might find a scenario like, “How would you handle an angry customer?” or “How do you respond when a customer asks for a refund?” Practicing how you might handle these or other scenarios common in your industry can help you call upon solutions quickly when they arise on the job.

- **Observe how others solve problems.** You may have colleagues who are skilled problem solvers. Observing how those colleagues solve problems can help you improve your own skills. If possible, ask one of your more experienced colleagues if you can observe their techniques. Asking relevant questions can be helpful in applying them in your own career.





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### ✓ How to highlight problem-solving skills

Showcasing your problem-solving skills on your resume and cover letter can help employers quickly understand how you might be of value to their team. You might consider only showcasing problem-solving skills on your resume if it is particularly relevant to the position you're applying for. Customer service, engineering and management positions, for example, would be good candidates for including problem-solving abilities.

### ✓ Problem-solving skills for resume

On your resume, you can highlight your problem-solving skills in several locations: The “skills” section, the “achievements” section and by giving specific examples of problem-solving in your “experience” section.

In the skills section, you may want to list key problem-solving skills that you possess instead of simply writing down the more generic term “problem-solving”. For example, you could list specific technical skills you possess that would help you solve problems or soft skills associated with problem-solving such as your research abilities or decision-making talents.

Remember, stories are powerful. Keep specific examples in mind of times you solved a problem. This is not only useful on your resume but will also help you answer interview questions like, “Tell me about a time you overcame an obstacle.”

### ✓ Problem-solving skills for cover letter :

Your cover letter is also an excellent opportunity to elaborate on your problem-solving skills. Here, you can give a brief example of a time you solved a problem successfully. Alternatively, you might identify a challenge that this potential employer is seeking to solve and explain how you would address it.

#### ➤ NEGOTIATION SKILL :

#### ✓ INTRODUCTION :



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Negotiation is a dialogue between two parties to resolve conflicts or issues so that both parties find the solution acceptable. Usually, it is a compromise involving give and take. Negotiation results when each party compromises to resolve a conflict for everyone's benefits. In the workplace, negotiations may take place between managers, departments, colleagues or between a team member and a manager. Even before you join the workplace, you may negotiate the job offer with the interviewer or HR manager.

In this article, we will discuss what negotiation skills are, its benefits, examples and tips for improving your negotiation skills.

### ***What are negotiation skills?***

Negotiation skills are inherent qualities that help two or more parties agree to a common logical solution. In the workplace, you may have to display your negotiating skills in various situations such as:

- Negotiating a salary hike with the HR manager after promotion
- Negotiating a project deadline with your team lead or manager
- Negotiating few days off for a family holiday with your manager
- Negotiating contract terms with a potential customer

Lack of negotiation skills affects the business bottom line and could ruin customer relationship. Negotiation skills are soft skills and essential to become a negotiator and resolve workplace conflicts.

However, this skill set depends on the work environment, the parties involved and outcome desired. Often, when one party is ready for reaching a compromise, the other party may be resistant. This makes negotiation difficult and you are likely to encounter such situations in the workplace. That is why you need to master your negotiation skills.

### ✓ **Benefits of negotiation skills**

Negotiation is a coveted leadership skill which helps businesses reach their business objective. Here are a few reasons negotiation skills are essential in the workplace:



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- **Builds a relationship:** Despite the difference in opinion, negotiation skills help strike a solution and focus more on creating goodwill and value. This builds a long-term relationship.
- **Delivers excellent solutions:** Good negotiation skills ensure that solutions to the conflicts are not short-term. It focuses on creating long-lasting solutions because both parties make a concession only when the solution is satisfactory.
- **Avoids future conflicts:** As both parties agree to a common solution, the chances of future conflicts reduce to a great extent.
- **Create an environment of business success:** Good negotiation skills ensure the accomplishment of business goals, which creates an environment of business success. This also increases the chances of future business transaction.

### ✓ Types of negotiation strategies

The negotiation strategies or approaches to negotiation you use depends on your situation. Most workplace negotiation are "win-lose" or "win-win". Here are 4 types of negotiation strategies:

- **Distributive negotiation**

It is also sometimes called "hard bargaining" because both parties argue over a single conflict. Distributive negotiation is a win-lose strategy because each party considers that their loss would benefit the counterparty. For example, when purchasing a SaaS tool, you may not want to lower the price as it would cause financial loss, whereas your customer feels you are overcharging them for your product by not giving discounts.

- **Integrative negotiation**

It is also sometimes called "interest-based bargaining" because it asserts that both parties can gain something and create value by offering trade-offs. This is a win-win strategy because the negotiation creates mutual gains for both parties. For example, when purchasing a SaaS tool, you quote the price as ₹ 2,000 per month, but the customer is adamant about paying only ₹1,600 per month. Both you may negotiate ₹1,800 per month price. It is a win-win situation because both parties win ₹ 200 per month.



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- **Negotiation with coworkers**

Your job may require working closely with different departments and without strong negotiation skills, it might be difficult for you to reach your goals. For example, when working as a software developer, a test automation engineer may flag a part of your code as a critical error. When you negotiate with the automation engineer, you both agree that the error is no longer valid because of the product's changed functionality. As a result, you develop a plan to ensure such instances do not happen again.

- **Negotiation with management**

One of the most challenging types of negotiation is with your manager or senior management. Often, you negotiate with such senior-level people for your job duties and salary benefits. This is a crucial workplace negotiation because your job satisfaction depends on it. Therefore, when negotiating about your salary and other perks, be clear and polite with what you expect.

- ✓ **Tips to improve your negotiation skills**

As negotiations skills are paramount in every business, you need to hone these skills continually. Here are a few important tips to improve your negotiation skills:

- **Prepare for the negotiation**

Enter a negotiation only after you know what you want and how willing you are to compromise to resolve the conflict.

- **Be ready to compromise**

Without compromise, it is impossible to reach a common consensus that is beneficial for both parties. Leave your ego behind when negotiating at the workplace and be ready to compromise on best fit terms.



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- **Set a timeline**

Without setting a timeline, a negotiation may go on for months or years. Setting a deadline or timeline motivates the parties to reach a compromise before the deadline.

- **Offer multiple solutions**

If a conflict is solvable in more than one way, it makes sense to present all the possible solutions at the beginning of a negotiation. This saves time and increases the probability of both parties choosing one solution of their preferred outcome.

- **Speak with confidence**

Negotiation is not about what you say; it is more about how you say. Therefore, it is imperative to speak confidently to make the other party believe that your solution is beneficial. Lack of confidence and self-assurance could result in negotiation terms that are more beneficial for the other party.

- **Learn to accept failures**

Often, when both parties' requirements are a world apart, reaching a compromise becomes difficult. You may fail at negotiation but never take this failure personally. Instead, accept it and revisit the entire negotiation to understand ways to improve your efforts.

- **Work on your weakness**

Your planning, communication, persuasion, problem-solving and listening skills will always complement your negotiation skills. So, it becomes essential to sharpen these skills. If you lack the power of persuasion or find it difficult to listen to others, you should work on these weaknesses to improve your negotiation skills.



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- **Practise negotiation**

One of the best ways to improve your negotiation skills is by practising. Create a mock negotiation scenario and practise it with your family or friends. The more you practise, the better negotiator you will become.

### UNIT : 2 COMMUNICATION

#### ➤ Meaning, Types And Features Of Business Letter :

##### ✓ **Meaning of business letter :**

Business letter is a written communication by business organizations. It is exchange of information in writing.

The information is of mutual interest for both sender and receiver. It is non-personal and formal. It creates a written record and deals with business matters. Business letter is written to maintain contacts with customers, suppliers, government, financial institutions, transporters and others. It can be related to:

- *Inquiries and orders:* They are about price, purchase or sale of goods and other business matters.
- *Acknowledgement:* They acknowledge the receipt of letters, goods, payment etc.
- *Complaints:* They are about customers complaints related to business transactions.
- *Notification:* They are public notices in newspapers related to business.



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

- *Circulars*: They provide general information to employees, salesperson and departments.

- *Relationships*: They attract new customers and retain old customers. They maintain good public relations.

### ✓ Types Of Business Letter :

- **Business letter can be divided into two types:**

#### 1. Internal business letter

It is written within the business **organization**. It can be between departments. It can be in same department. It is needed to perform business functions. It is inward.

#### 2. External business letter

It is sent outside the **business** organization. It is from one business organization to another business organization. It connects the business with outside world. It can be both inward and outward.

### ✓ **Features of business letter :**

- **Followings are the main features of business letter:**

- Business letter is written for business purpose.
- Business letter is mostly in the form of letters and e-mail.
- Business letter involves two or more business parties.





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- **Business letter** is generally written in polite and impressive language.
- Secrecy is important in business letters.
- There is no prescribed format for writing business letters.

### ✓ Inward structure of business letter

- **Heading:** A business letter is different from a personal letter as it follows certain formalities. Heading is one of the formalities of a business letter. Heading indicates the name and postal address of the writer. Heading printed at the top of the page is called the letter head. A letter head is an expression of a firm's personality. Heading contains the following information: - The firm's name - Nature of business - The firm's full postal address - Symbols and trademarks - Telephone number - Fax number - e-mail address The heading is typed in the middle of the paper sheet at the top of the letter. The nature of the business is mentioned in the second line. In letterhead the firm's full postal address is typed on the right hand side and firm's telephone number, fax number and e-mail address are typed on the left hand side. Heading is considered to be the window of a firm. All the activities of the firm should be reflected in the heading. It should not contain maxims; moreover the name of the branches should not be mentioned. Heading is also known as 'head address' or 'letterhead'.
- **Date:** Since a business letter is an important document for the purpose of reference and has a legal value, it is necessary to write a date in full on every letter. All business letters should have correct date, typed under the letterhead. The date records when the letter was written, and may serve as an important reference. The date should be written on the righthand side of the letter, just below the heading. In a block or semi block form it is written on the right hand side. In a full block form it is written on the left hand side. There are two methods of writing dates in a letter. They are known as American method or cardinal method and British or ordinal method. The American method follows the chronological order of name of the month, date and year. To indicate a date cardinal numberings are used E.g. March 1, 2012. The British method



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follows the chronological order of date, name of the month and year. To indicate a date ordinal numberings are used. E.g. 1st March 2012 One must avoid the practice of writing dates in figures. As both the methods have different chronological patterns there are chances of misunderstandings. Therefore it is advisable not to mention date in figures.

- **Inside address:** The inside address contains the name and address of the person or firm to whom the letter is written. It is written on the left hand side of the sheet below the date and above the salutation. It can be written in either the indented form or in the block form. In the indented form the first line begins at the margin whereas the subsequent lines begin two space away from the beginning of the previous line. In this case each line ends with comma and the last one ends with full stop. The block form has all the lines beginning at the margin and no punctuation at the end of any line.
- **Salutation:** The salutation is a complementary greeting. It is written below the last line of the inside address. The form of salutation depends upon the personal relations between the writer and the addressee. If you are addressing a firm, a company, a club, a society or an association use 'Dear sirs' while writing to an officer by designation, write 'Dear Sir' or 'Dear Madam'. If the organization you are writing is consist of only women then use the salutation 'Dear Mesdames'. If you write a letter by name then use 'Dear Mr. /Miss/Ms' then his/her name. Sometimes sales and circular letters are addressed as, 'Dear Customer' or 'Dear Subscriber'.
- **Subject Line:** The subject line summarizes the topic of the letter in a few words. As it is a part of the body of the letter, it is centered about two lines below the salutation. The subject line reflects the central idea of the letter very clearly. The word 'Subject/ Referring to' is followed by a colon.
- **Body of the letter:** The main purpose of a letter is to convey a message, and the main purpose of the message is to produce suitable responses in the reader. This is done mainly through the body of the letter. It is the most important part of a business letter. It contains the message or information to be communicated. The body of the letter presents the message in an artistic and persuasive manner. The qualities which



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are essential for a good business letter are to be implemented through the body of the letter. The message is to be presented in as brief as possible manner. Moreover the tone of the letter should be courteous and cheerful. Usually the body of the letter is divided in to three parts: Beginning/opening paragraph, middle paragraph and ending/closing paragraph. The purpose of the paragraphing is to help the writer to convey his message more clearly and thus to make thing easier for the reader. In business letter the opening paragraph should be brief and should only give a reference to the letter received from the addressee and may introduce the message. This paragraph should arrest the interest of the reader and make him go through the whole letter. Middle paragraph conveys the main message of the letter. This paragraph elaborates the message that has been introduced in the opening paragraph. It should be brief and to the point. In the closing paragraph writer once again refers to the main purpose of writing the letter. the writer should clearly state what action he expects the reader to take. The closing should be effective as it leaves the last impression on the mind of the reader. The writer may end the letter indicating his expectations, wishes or intentions.

- **Complementary close:** The complementary close or subscription is a symbol of courtesy. It is a polite way of ending a letter. It appears at the foot of the letter just above the signature line and consists of the expression of respect to the addressee. This is a kind of conversational good-bye. Salutation and complementary close should correspond to each other. If salutation is 'Dear sir/madam' then complementary close should be 'Yours faithfully', if person's name is mentioned in salutation then complementary close should be 'Yours sincerely', 'Respectfully is used only when writing to a high official. Only the first word of the complementary close begins with a capital letter. the close is always followed by a comma.
- **Signature:** The signature is placed after the complementary close. It should be written by hand. The name of the person should be typed below his signature. The signature of a sole trader should be his name. In the case of a firm any of the partners of a firm should sign on behalf of the firm. He may do this by typing the name of the firm and



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putting his own signature below the name of the firm. In case for limited company some important official of the company such as a manager, managing director or the secretary should sign a letter on behalf of the company.

- **FORMS OF LAYOUT :**

Formate styles most often used in business letters include (1) **indented**, (2) **semi block**, (3) **modified block** and (4) **full block**. The main differences among them are the placement of the date, complimentary close and signature block and whether paragraph indentions are used.

1. **MODIFIED BLOCK FORMATE** : A modified block style letter is a common format used when writing a business letter. It varies slightly from a block style letter with the major difference being the **placement of the return address, date, and complimentary closing**.
2. **SEMI BLOCK** : All elements are left-aligned, except for the beginning of each paragraph, which is indented five spaces. Paragraphs are separated by a double line space.
3. **INDENTED FORM**: All body paragraphs begin at the left margin. Blocked Paragraphs Simplified All letter parts begin at the left margin.
4. **FULL BLOCK FORM** : In a full block business letter, every component of the letter (**heading, address, salutation, body, salutation, signature, identification, enclosures**) is aligned to the left. Also, first sentences of paragraphs are not indented.

➤ **Optional parts of a business letter :**



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### Enclosure:

The meaning of enclosure is to attach some documents with the letter. Enclosures are related documents sent with a letter such as; bills, cheques, quotations, brochures, price-lists etc. which have been mentioned in the letter and are sent as enclosures. The abbreviation of enclosure is 'Encl.'. It is not a regular part of the layout of a business letter. It is written only when some documents are to be sent with the letter. If there are many enclosures, they are numbered and placed behind the letter in the order of their serial number. It is written at the bottom left of the letter, after the signature. The enclosure line is very useful to the recipient of the letter. By reading the enclosure receiver comes to know that some more documents have been sent with the letter. If you wish the reader to return any of the documents, type/ Write RETURN after the item.

### Post Script:

Postscript (postscriptum) or P.S. means something written outside the main script it is a bit of writing, not more than three lines, added to the letter after the signature and after enclosures. Writing a post script indicates that the writer had forgotten to include something important in the body of the letter or bit of information which is not a part of main message of the letter. It is often written in hand at the time of signing the letter. It is also used to add a friendly personal note to a formal letter. It enables the writer to establish personal contact.

**Superscription:** In commercial correspondence the word superscription refers to anything that is written on the envelope. The meaning of subscription is "Something written outside". As it is written outside, it includes the sender's address and the recipient's address as well. Sometimes in response to advertisements for jobs, candidates are advised to superscribe their applications.

**Identification line / Reference Initials:** The reference initials refer to the person who has dictated the letter and the person who has typed out the letter. This line appears two spaces below the last line of the signature, on the left hand side of the paper sheet. In modern institutes the signatory may not be the person who has drafted the letter. The letter must have been typed out by the typist and it might be drafted by third person so identification line



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enables us to know the name of the person who has drafted the letter and the person who has typed out the letter.

### ➤ Outward Appearance Of A Business Letter :

#### 1. Stationery :

Business firms should take extra care while selecting paper/ stationery, for the purpose of writing a business letter. The paper selected for the purpose of writing a business letter, should be smooth, durable, and white or light in colour. Rough paper spoil the image of the firm.

#### 2. Letterhead :

a sheet of paper on which the firm's name and its full postal address are printed at top center is known as letterhead. Letterhead also contains the symbol of the firm. Letterhead can be made attractive by limiting information to be conveyed. Letterheads are available in two popular size :

- (1) The standard size – 8.5" \* 11" is convenient for standard messages.
- (2) The smaller size is – 5" \* 8" - for short message.

#### 3. Paragraphing :

Paragraphing is not merely a matter of drafting. It is a matter of appearance too. Paragraphing enables us to divide the content of the letter into logical and readable units. A business letter has three paragraph, namely, beginning, middle and closing paragraphs. Each paragraph should be as long as is necessary to develop an idea.

#### 4. Typing :

Usually personal letters are hand-written. On the contrary business letters are type-written. Typing must be neat and even. A good business letter must be free from typing errors. Poor



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erasing reflect adversely on the firm. There are no hard and fast rules regarding spacing. But the typed part should look balanced with the blank part.

### 5. Margin :

A picture in a frame pleases our eyes. It is because, of the proper spacing/margin that is kept on all sides of the picture at the time of framing the picture. Similarly, the typist should keep proper margin on all sides of the letterhead. The width of margin depends on the size of the letter and the length of the content of the letter. Generally a margin of an inch and a half is kept on either side of a letter. Margin is also useful while filing a letter.

### 6. Folding :

It is our common impression that folding of a letter is the least important aspect of letter writing. But folding requires special skill on the part of the business letter writer. Generally two or three folds lengthwise and one or two folds breadth wise are advisable.

### 7. Envelope :

The envelope matches with the inside letter in terms of colour, quality and size. Envelopes are available in various sizes. But the most popular among them are 1) 3.5" \* 5.5" for single sheet letters and 2) 4.5" \* 10.5" for letters with more sheets. Window envelopes have a transparent panel where the receiver's address is to be printed. In case of such envelopes the letter is folded in such a way that the inside address can be read from outside. Thus it saves time and energy of the dispatcher.

### ESSENTIAL QUALITIES OF A BUSINESS LETTER:





## SHREE H. N. SHUKLA COLLEGE OF I.T. & MGMT.

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### ***Essential Qualities of Business Letter***

A person should always maintain the quality of the business letter. The qualities of a business letter make it presentable. It becomes easy for a person or an organization to imprint an impression onto the others. The qualities of a business letter can be classified as

- Inner Quality
- Outer Quality

Let us discuss each of them in detail.

#### **I. Inner Quality**

It refers to the quality of language used and the presentation of a business letter. They are

##### **1. Clear**

The language used in the business letter must be clear. It helps the receiver to understand the message immediately, easily, and clearly. Any ambiguity will lead to the misinterpretation of the message stated.

##### **2. Simple**

The language used in the business letter must be simple and easy. One must not write a business letter in difficult and fancy words.

##### **3. Concise**

The message written in the letter must be concise and to the point.

##### **4. Concrete**

The message is written must be concrete and specific. By using concrete language, a reader will have a clear picture of the message.



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### 5. Accuracy

One must always check for the accuracy of the business letter. Accuracy generally means no error in grammar, spelling, punctuations etc. Correct personnel should be targeted for communication.

### 6. Coherent

The language used in the business letter must be coherent. The message must be in a logical way for the clear understanding of the message. The flow of the message must be consistent.

### 7. Complete

One must write a complete message. It helps the reader to know about the issue and the solution to be taken. It should provide all the necessary information. One must also keep in mind that the message should be concise and short along with the complete details.

### 8. Relevance

The letter should only contain important information. Irrelevant information should not be included and avoided in any business communication.

### 9. Courteous

The language used in the business letter must be courteous. A writer must always use open, friendly, and honest wording in his letter. It does not mean that one must use slang and abusive words. One must always add the words like please, thank you etc.

### 10. Neatness

A business letter must be neatly typed or handwritten. Proper spacing, indention, and use of paragraph should be used.



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### II. Outer Quality

The outer quality of a business letter means the quality of its outer appearance. The outer look of the letter must be catchy and impressive. Some of the outer qualities are

#### 1. Size of the Paper

The standard size of paper should be used. An A4 paper is the most used paper for writing a business letter.

#### 2. Quality of the Paper

The quality of the paper used must be good. It is not always possible for a firm to use the costly paper. One must use good quality paper for original copy and ordinary copy for the duplicate copy.

#### 3. The Color of the Paper

Sometimes it is very useful to use the different color of paper for different types of letter. The receiver can clearly understand the intention and the purpose of the letter by its color.



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### 4. Folding of Letter

One must fold the letter properly and uniformly. The folding must be done to fit the letter in the envelope. It is noticeable that one must not over fold the letter. It will have a bad impression on the reader's mind.

### 5. Envelope

The envelope used must be of good quality. Special attention must be given to the size of the envelope for fitting the letter.

#### ➤ What is Your Attitude in Business Communication:

As we know from analyzing our own mental filters, we human beings are self-centered creatures. Because we are self-centered, we tend to see each situation from our own points of view. In *letter writing situations*, this attitude may lead us to a writer-oriented, we-view point approach—one that places emphasis on ourselves and our interests rather than on our readers and their interests.

Such approaches obviously do not elicit the most positive responses in our readers, because they too are self-centered. The result is not conducive to building goodwill, nor does it help get your readers to do things you want them to do. You can achieve more positive effects by writing in the reader's point of view.

The '**you attitude**' is **writing style** that emphasizes readers rather than the writer. To [write business letter](#) we should not focus or put our self in the place of receivers. Their desires, problems, circumstances, emotions and probable reactions are to be taken into consideration. Business letter must be written from 'you viewpoint' instead of 'I or we viewpoint'. You viewpoint emphasize reader's interest and help to win the reader's mind and attention. For example:

1. **I or We attitude:** We are sure that our view discount policy will attractive to you.  
**You attitude:** You will surely appreciate new discount policy.
2. **I or We attitude:** I am happy to hear that you have selected our firms.  
**You attitude:** Thank you for giving us the opportunity to serve you.



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3. **I or we Attitude:** I will give you 10% discount  
**You attitude:** You can get 10% discount

**Complaint letter:**



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[Date]

To

[Recipient Name]

[Title]

[Company Name]

[Street Address] [City, ST ZIP Code]

We have entered an era of technology and communication where telephone has taken the place of basic necessity in our life. I have been using this phone service for 5 years and I was very content with the quality. But I have never faced this problem before. My line is very bad, and I can hardly hear the person on the other side. This not only creates frustration for me, but it also disturbs the other person. Telephone is very important in this day and age. I expect calls from my family and friends frequently and not being able to speak to them properly breaks my heart.

Besides this, I use telephone for work purpose as well. I work from home and collect orders from my telephone. The bad line was one of the issues but recently, the line not working at all has further aggravated the matter. This poor service is reflecting badly on my personal as well as professional life. I have been coming personally to place a complaint and no action has been taken yet.

I am writing this letter as a matter of urgency and I would be very thankful if my complaint gets proceeded and my issue is resolved in no time. I expect better service in the future for the price that I pay. I am looking forward to hearing back from the respected authorities as soon as possible.

Regards,

[Your Name]

[Title]

[wordsofice.com](http://wordsofice.com)



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Reply to complain letter :

## RESPONSE TO COMPLAINT LETTER

{{Address Sender}}

Date : November 16, 2020

{{Name Recipient}}  
{{Address Recipient}}

**Subject :** {{Subject}}

Dear Sir/Madam {{Name}},

First of all, let me express my sincere apologies for the unintentional mistake and the inconvenience caused thereafter. These incidents are not typical of us and we are disturbed about this as much as you are.

I have run a quick investigation to find out the reasons that led to this error and I came to the conclusion that it's due to [state the reasons here. Make it short]. This is clearly a mistake at our end and we take responsibility for it.

In our best efforts to keep our customers happy and satisfied, we are going to {{give you a new item, refund your money, etc...}}. This is the least that we can do in the light of this unfortunate event. We strive for your satisfaction and we want to ensure a gratifying experience for all of our customers.

I would also like to inform you that we will take extra measures to make sure that such errors don't happen again in the future.

I apologize again for the inconvenience.

Yours sincerely,

{{Signature}}

{{Formal Name}} {{Title}}





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### Unit : 3 Questionnaire

#### ➤ What is a Questionnaire?

A questionnaire is a research instrument that consists of a set of questions or other types of prompts that aims to collect information from a respondent. A research questionnaire is typically a mix of [close-ended questions](#) and [open-ended questions](#). Open-ended, long-form questions offer the respondent the ability to elaborate on their thoughts. Research questionnaires were developed in 1838 by the Statistical Society of London.

The data collected from a data collection questionnaire can be both [qualitative](#) as well as [quantitative](#) in nature. A questionnaire may or may not be delivered in the form of a [survey](#), but a survey always consists of a questionnaire.

#### Questionnaire Examples

The best way to understand how questionnaires work is to see the types of questionnaires available. Some examples of a questionnaire are:

1. **Customer Satisfaction Questionnaire:** This type of research can be used in any situation where there's an interaction between a customer and an organization. For example, you might send a customer satisfaction survey after someone eats at your restaurant. You can use the study to determine if your staff is offering excellent customer service and a positive overall experience.
2. **Product Use Satisfaction:** You can use this template to better understand your product's usage trends and similar products. This also allows you to collect customer preferences about the types of products they enjoy or want to see on the market.



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3. **Company Communications Evaluation:** Unlike the other examples, a company communications evaluation looks at internal and external communications. It can be used to check if the policies of the organization are being enforced across the board, both with employees and clients.

The above survey questions are typically easy to use, understand, and execute. Additionally, the standardized answers of a survey questionnaire instead of a person-to-person conversation make it easier to compile useable data.

The most significant limitation of a data collection questionnaire is that respondents need to read all of the questions and respond to them. For example, you send an invitation through email asking respondents to complete the questions on social media. If a target respondent doesn't have the right social media profiles, they

➤ **Advantages of a good design:**

- With a survey questionnaire, you can gather a lot of data in less time.
- There is less chance of any bias creeping if you have a standard set of questions to be used to your target audience. You can apply logic to questions based on the respondents' answers, but the questionnaire will remain standard for a group of respondents that fall in the same segment.
- Surveying online survey software is quick and cost-effective. It offers you a rich set of features to design, distribute, and analyze the response data.
- It can be customized to reflect your brand voice. Thus, it can be used to reinforce your brand image.
- The responses can be compared with the historical data and understand the shift in respondents' choices and experiences.
- Respondents can answer the questionnaire without revealing their identity. Also, many survey software complies with significant data security and privacy regulations.



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Ph. No–(0281)2471645

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Nr. Amrapali Railway Crossing  
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### ➤ Characteristics of a good questionnaire

Your survey design depends on the type of information you need to collect from respondents. Qualitative questionnaires are used when there is a need to collect exploratory information to help prove or disprove a hypothesis. Quantitative questionnaires are used to validate or test a previously generated hypothesis. However, most questionnaires follow some essential characteristics:

- **Uniformity:** Questionnaires are very useful to collect demographic information, personal opinions, facts, or attitudes from respondents. One of the most significant attributes of a research form is uniform design and standardization. Every respondent sees the same questions. This helps in [data collection](#) and [statistical analysis](#) of this data. For example, the [retail store evaluation questionnaire template](#) contains questions for evaluating retail store experiences. Questions relate to purchase value, range of options for product selections, and quality of merchandise. These questions are uniform for all customers.
- **Exploratory:** It should be exploratory to collect qualitative data. There is no restriction on questions that can be in your questionnaire. For example, you use a data collection questionnaire and send it to the female of the household to understand her spending and saving habits relative to the household income. Open-ended questions give you more insight and allow the respondents to explain their practices. A very structured question list could limit the data collection.
- **Question Sequence:** It typically follows a structured flow of questions to increase the number of responses. This sequence of questions is screening questions, warm-up questions, transition questions, skip questions, challenging questions, and classification questions. For example, our [motivation and buying experience questionnaire template](#) covers initial demographic questions and then asks for time spent in sections of the store and the rationale behind purchases.

### ➤ Types & Definitions:

As we explored before, questionnaires can be either structured or free-flowing. Let's take a closer look at what that entails for your surveys.



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- **Structured Questionnaires:** Structured questionnaires collect [quantitative data](#). The questionnaire is planned and designed to gather precise information. It also initiates a formal inquiry, supplements data, checks previously accumulated data, and helps validate any prior hypothesis.
- **Unstructured Questionnaires:** Unstructured questionnaires collect [qualitative data](#). They use a basic structure and some branching questions but nothing that limits the responses of a respondent. The questions are more open-ended to collect specific data from participants.

### Types of questions in a questionnaire

You can use multiple question types in a questionnaire. Using various question types can help increase responses to your research questionnaire as they tend to keep participants more engaged. The [best customer satisfaction survey templates](#) are the most commonly used for better insights and decision-making.

Some of the widely used [types of questions](#) are:

- **Open-Ended Questions:** [Open-ended questions](#) help collect qualitative data in a questionnaire where the respondent can answer in a free form with little to no restrictions.
- **Dichotomous Questions:** The [dichotomous question](#) is generally a “yes/no” [close-ended question](#). This question is usually used in case of the need for necessary validation. It is the most natural form of a questionnaire.
- **Multiple-Choice Questions:** [Multiple-choice questions](#) are a close-ended question type in which a respondent has to select one (single-select multiple-choice question) or many (multi-select multiple choice question) responses from a given list of options. The multiple-choice question consists of an incomplete stem (question), right answer or answers, incorrect answers, close alternatives, and distractors. Of course, not all multiple-choice questions have all of the answer types. For example, you probably won't have the wrong or right answers if you're looking for customer opinion.



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- **Scaling Questions:** These questions are based on the principles of the four measurement scales – [nominal](#), [ordinal](#), [interval](#), and [ratio](#). A few of the question types that utilize these scales' fundamental properties are [rank order questions](#), [Likert scale questions](#), [semantic differential scale questions](#), and [Stapel scale questions](#).
- **Pictorial Questions:** This question type is easy to use and encourages respondents to answer. It works similarly to a multiple-choice question. Respondents are asked a question, and the answer choices are images. This helps respondents choose an answer quickly without over-thinking their answers, giving you more accurate data.
- **Types of Questionnaires based on Distribution:**
- **Online Questionnaire:** In this type, respondents are sent the questionnaire via email or other online mediums. This method is generally cost-effective and time-efficient. Respondents can also answer at leisure. Without the pressure to respond immediately, responses may be more accurate. The disadvantage, however, is that respondents can easily ignore these questionnaires. Read more about [online surveys](#).
- **Telephone Questionnaire:** A researcher makes a phone call to a respondent to collect responses directly. Responses are quick once you have a respondent on the phone. However, a lot of times, the respondents hesitate to give out much information over the phone. It is also an expensive way of conducting research. You're usually not able to collect as many responses as other types of questionnaires, so your [sample](#) may not represent the broader population.
- **In-House Questionnaire:** This type is used by a researcher who visits the respondent's home or workplace. The advantage of this method is that the respondent is in a comfortable and natural environment, and in-depth data can be collected. The disadvantage, though, is that it is expensive and slow to conduct.
- **Mail Questionnaire:** These are starting to be obsolete but are still being used in some [market research studies](#). This method involves a researcher sending a physical data collection questionnaire request to a respondent that can be filled in and sent back. The



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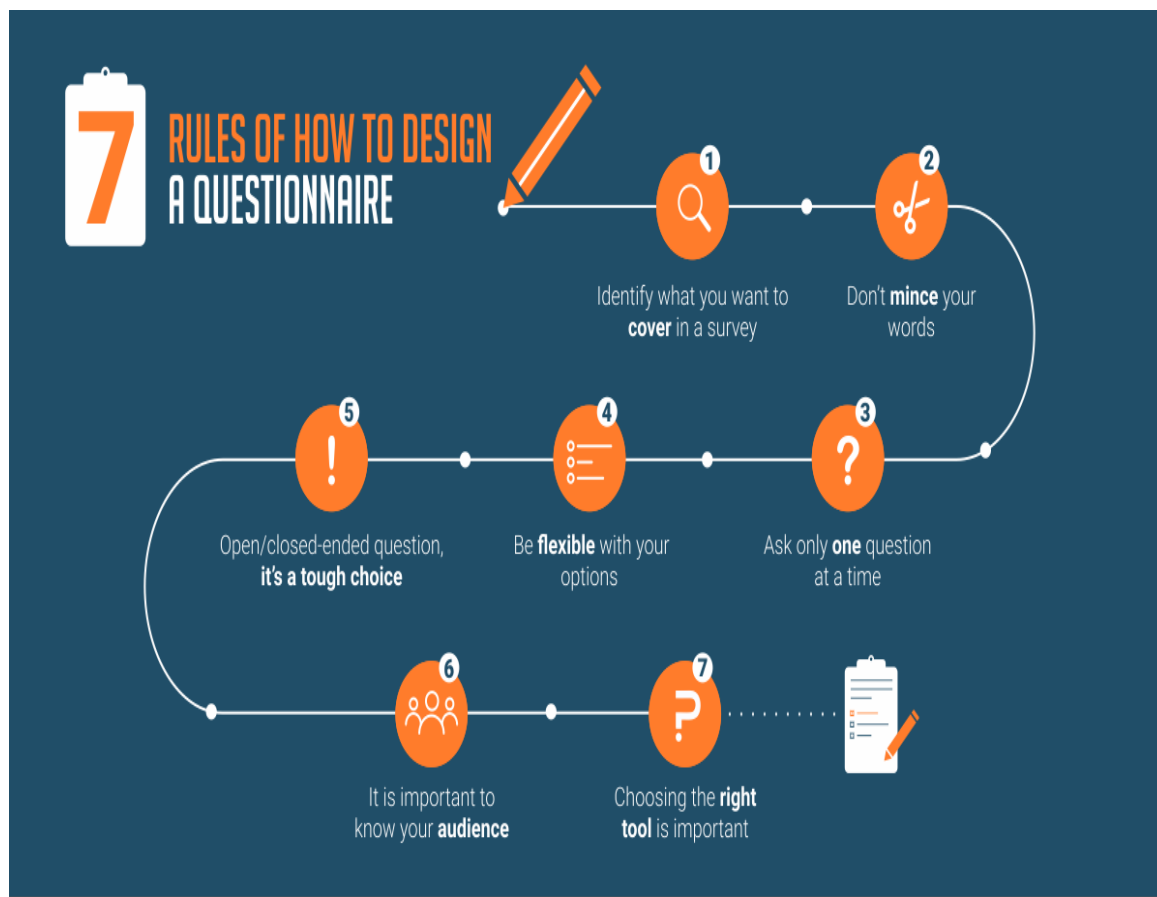
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advantage of this method is that respondents can complete this on their own time to answer truthfully and entirely. The disadvantage is that this method is expensive and time-consuming. There is also a high risk of not collecting enough responses to make actionable insights from the data.

### A good questionnaire design



Questionnaire design is a multistep process that requires attention to detail at every step.

Researchers are always hoping that the responses received for a survey questionnaire yields useable data. If the questionnaire is too complicated, there is a fair chance that the respondent might get confused and will drop out or answer inaccurately.



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As a [survey creator](#), you may want to pre-test the survey by administering it to a focus group during development. You can try out a few different questionnaire designs to determine which resonates best with your target audience. Pre-testing is a good practice as the survey creator can comprehend the initial stages if there are any changes required in the survey.

### ➤ Steps Involved in Questionnaire Design

#### 1. Identify the scope of your research:

Think about what your questionnaire is going to include before you start designing the look of it. The clarity of the topic is of utmost importance as this is the primary step in creating the questionnaire. Once you are clear on the purpose of the questionnaire, you can begin the design process.

#### 2. Keep it simple:

The words or phrases you use while writing the questionnaire must be easy to understand. If the questions are unclear, the respondents may simply choose any answer and skew the data you collect.

#### 3. Ask only one question at a time:

At times, a researcher may be tempted to add two similar questions. This might seem like an excellent way to consolidate answers to related issues, but it can confuse your respondents or lead to inaccurate data. If any of your questions contain the word “and,” take another look. This question likely has two parts, which can affect the quality of your data.

#### 4. Be flexible with your options:

While designing, the survey creator needs to be flexible in terms of “option choice” for the respondents. Sometimes the respondents may not necessarily want to choose from the answer options provided by the survey creator. An “other” option often helps keep respondents engaged in the survey.





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### 5. The open-ended or closed-ended question is a tough choice:

The survey creator might end up in a situation where they need to make distinct choices between open or [close-ended questions](#). The question type should be carefully chosen as it defines the tone and importance of asking the question in the first place.

If the questionnaire requires the respondents to elaborate on their thoughts, an [open-ended question](#) is the best choice. If the surveyor wants a specific response, then close-ended questions should be their primary choice. The key to asking closed-ended questions is to generate data that is easy to analyze and spot trends.

### 6. It is essential to know your audience:

A researcher should know their target audience. For example, if the target audience speaks mostly Spanish, sending the questionnaire in any other language would lower the response rate and accuracy of data. Something that may seem clear to you may be confusing to your respondents. Use simple language and terminology that your respondents will understand, and avoid technical jargon and industry-specific language that might confuse your respondents.

For efficient market research, researchers need a representative sample collected using one of the many [sampling techniques](#), such as a sample questionnaire. It is imperative to plan and define these target respondents based on the [demographics](#) required.

### 7. Choosing the right tool is essential:

QuestionPro is a simple yet advanced survey software platform that the surveyors can use to create a questionnaire or choose from the already existing 300+ questionnaire templates.

Always save personal questions for last. Sensitive questions may cause respondents to drop off before completing. If these questions are at the end, the respondent has had time to become more comfortable with the interview and are more likely to answer personal or demographic questions.



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### ➤ What are the business survey questions? :

The business survey questions are the questionnaires that can help you make well-informed decisions and maximize the potential of your business. It will enable a researcher to understand the industry, current and prospective customers, competitors, internal problems, and markets.

For example, an energy drink company wants to understand public opinion about their product and the factors that influence that choice when choosing an energy drink. In such a case, an [energy drinks survey](#), which includes business-related survey questions, will enable the company to gather data to help them brand their product and market it accordingly to gain a higher market share.

Business survey questions, when asked correctly, can advance your business in leaps and bounds. It can help you with the following points that are crucial to any business.

- **To build customer relationships** – Customer relationship with the company is one of the most important parameters that can build a business or destroy a business. To understand where you stand, the [Net Promoter Score \(NPS\)](#) needs to be identified. Asking questions using the [NPS survey](#) to gather such data can help you build a long-lasting relationship with the customer and make them your brand ambassadors who recommend you to their friends and colleagues.
- **Improve your customer service** – Customer service leads to customer satisfaction. If a customer is satisfied, they would keep coming back to you for more and promote your business. A happy customer is a loyal customer. Using business survey questions in customer satisfaction surveys or [customer service surveys](#), calculate customer satisfaction scores (CSAT) and customer effort scores (CES). You can use this data to improve customer satisfaction through excellent customer service.
- **Understand feedback** – Feedback is what changes the entire business strategy. When you know what is going wrong, you can improve or correct it. Use business survey questions in feedback surveys such as [product satisfaction surveys](#) to gather feedback from existing customers and prospective customers to better your product or service and retain customers through [customer loss surveys](#).



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- **To improve productivity** – A happy workforce is directly proportional to business success. If the employees are not satisfied, the business will not provide value to its customers. Hence, to understand your employees' satisfaction level, [employee satisfaction survey](#) questions can be asked to your employees, increasing productivity and branding.

### ✓ Business survey questions for product/service feedback :

1. What is the main benefit you receive from using our product/service?
2. What are the top 3 benefits you get from our product/service?
3. How long have you been using our product/service?
  1. Less than a month
  2. 1 to 6 months
  3. 6 months to 1 year
  4. 1-3 years
  5. Not sure
  6. Never used
  7. Other (Please specify)
4. How often do you use our product/service?
  1. Daily
  2. Once a week
  3. 2-3 times a month
  4. Once a month
  5. Every 2-3 months
  6. 2-3 times a year or less
  7. Not sure
  8. Other
5. Overall, how satisfied are you with our product/service?
  1. Very satisfied
  2. Satisfied
  3. Neutral
  4. Dissatisfied
  5. Very dissatisfied



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6. Not sure
6. Would you use/purchase our product/service again?
  1. Definitely
  2. Probably
  3. Not sure
  4. Probably not
  5. Definitely not
  6. Never used
7. What alternative brand would you go to if our product/service was not available anymore?
  1. Competitor 1
  2. Competitor 2
  3. Competitor 3
  4. Competitor 4
  5. Not sure
8. Did the customer support team resolve all your product/service related queries?
  1. Yes, by the company or its representative
  2. No, it was resolved by me, or someone outside the company
  3. No, the problem was never resolved
  4. No problems, so never contacted the support team

9. What recommendations would you offer to improve our product/service?

The above questions are business survey questions that enable a researcher to understand customer opinions about a product/service. It allows the researcher to gather feedback on the product, identify gaps, and thus helps the company to make changes to processes or the product/service accordingly.

### ✓ Business survey questions for market research :

1. In your opinion, what are the things that you like most about the product/service?



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2. In your opinion, what improvements can be made to the product/service?
3. What is it that you like most about competing products currently available?
4. In your opinion, what improvements can be made for the competing products now available?
5. What are the reasons for which you might choose our product/service?
  1. I already had it, but want to replace it
  2. It serves a need of mine
  3. For quality reasons
  4. For durability reasons
  5. Because of the price
  6. Other
6. What is the reason, because of which you might not choose our product/service?
  1. It is very costly
  2. I don't need it
  3. Quality is not up to the mark
  4. It is not durable
  5. I already have it
  6. Other
7. How likely are you to choose our product/service over competing products in the market?
  1. Extremely likely
  2. Very likely
  3. Somewhat likely
  4. Not so likely
  5. Not at all likely

Market research questions enable a researcher to understand the market. Such questions can help companies before launching a product/service into the market. Gathering feedback from the target audience will enable the company to understand the demand in the market and improve the product to capture a higher market share.



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### ✓ Business survey questions to measure customer satisfaction:

1. Considering your complete experience with our company, how likely are you to recommend us to a friend or a colleague?
2. In your opinion, which of the following word describes us/our product the closest?
  1. Faulty
  2. Low quality
  3. High quality
  4. Durable
  5. Not durable
  6. Economical
  7. Expensive
  8. Other
3. To what extent does our product meet your need?
  1. Completely
  2. Somewhat
  3. Very little
  4. Does not meet the need
4. Which three features of our product/service are most important to you?
5. Which three features of our product/service need improvement?

### Employee Satisfaction Survey Questions Related to Workplace Culture

Culture is the key to having satisfied employees.

#### 01. Do you enjoy our company's culture?

According to our 2019 Employee Engagement Report, the invisible company culture reigns supreme. The top factors related to employee happiness turn out to be intangible ones: interpersonal relationships, culture, and work environment.

If your employees don't like your culture, it's impossible to take your organization where you want it to go.



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### 02. Do you feel connected to your coworkers?

Coworkers are the number one thing employees like about their jobs. However, according to our Engagement Report, only 24% of employees feel connected to their colleagues.

It's impossible for your employees to be truly satisfied at work when they don't have any friends at the office.

### 03. How open to change are we as an organization?

It's essential to understand how employees perceive your willingness to make changes. They'll only feel valued and be motivated to provide feedback if they know their opinions are going to make an impact.

### 04. Do your managers value your feedback?

Just because they may not be senior-level managers doesn't mean your employees don't have fantastic ideas of their own.

It's disheartening to work for someone who never asks for your opinion or ideas. If your employees are never asked to provide their feedback, chances are they're not satisfied.

### Employee Satisfaction Survey Questions Related to the Management

An employee's relationship with their manager and how the latter behaves could have a major impact on worker satisfaction and employee experience levels.

### 05. Do you feel valued for your contributions?

Our Engagement Report revealed only 25% of workers feel as though their employers recognize their hard work on a consistent basis — a 16% drop from the previous year.

Make employee recognition a top priority if you want your workers to stick around.

### 06. Do your superiors communicate company news effectively and in a timely manner?





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Employees spend at least 40 hours — if not many more — at the office each week.

That being the case, it's only fair that you clue them in on major developments that take place. Nobody likes being blindsided by important news that affects their jobs

### 07. Does management seem invested in the success of the team?

If your employees believe that management is just there to boss people around and collect a paycheck, there's no chance they'll be satisfied or motivated.

### 08. How transparent do you feel the management is?

Our research shows that while 39% of managers strongly agree that management within their organization is transparent, only 22% of employees feel the same way. This pervasive blind spot must be addressed in order for employees to function effectively in their roles.

### 09. Do you think that work is distributed evenly across your team?

According to our research, nearly 70% of workers believe there's not enough time in the week to get all of their work done.

It's one thing if everyone on the team is overworked and have little or no work-life balance. It's quite another if certain members have work piled on them while others do not.

This usually happens when there's a lack of strong leadership, and employee feedback can help reveal this flaw.

#### ➤ Employee Satisfaction Survey Questions Related to the Actual Job

Last but not least, you can't really measure employee satisfaction if you don't include some questions about the actual job and/or the nature of work itself.

### 10. Do you find your work meaningful?

In a recent survey, millennials indicated that the ability to tackle meaningful work was just as important as salary when considering where to work.

If your employees don't find their work meaningful, they are unlikely to be engaged.



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### 11. Does our company offer adequate opportunities for promotions and career development?

Many of today's workers care a great deal about having opportunities to climb the corporate ladder and otherwise develop in their careers.

Yet, according to our research, only one in three people strongly agree that they have the opportunity to reach their full potential at their organization.

If you don't support career growth, your employees will not be happy.

### 14. Do you feel like your job utilizes your skills and abilities as much as it could?

It's extremely difficult for employees to be satisfied when they feel as though their employers are ignoring their strongest skills.

If your employee satisfaction survey reveals that many members of your team don't feel like their talents and know-how are being fully leveraged, start encouraging your workers to pursue pet projects and collaborate with colleagues in other departments

### 15. How happy are you at work?

Want to know if your employees are satisfied? Ask them how happy they are at work!

This question does not fall under any specific category. Rather, it provides a concrete answer to HR about the general satisfaction and happiness levels.

Understanding your employees' true feelings and monitoring the trends over time will help you detect an issue before it becomes a problem. From there, you can ask follow up questions to open the dialogue and see if there's anything you can do to improve their experience.



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## Unit : 4 Grammar

What are modal verbs?

**Can → ability, permission, request, possibility.**

**Could → ability, request, possibility.**

**May → permission, possibility, wishes, purpose, concession.**

**Might → permission, possibility, concession, reproach.**

**Must → necessity, prohibition, compulsion, obligation, certainly, probability.**

**Shall → futurity, willingness, intention, suggestion, insistence.**

**Should → obligation, advisability, necessity, expectation.**

**Ought to → moral obligation, duty, necessity, desirability.**

**Will → futurity, willingness, intension, prediction, insistence, request.**

**Would → willingness, habitual action, necessity, expectation.**

**Used to - → past discontinued habit.**

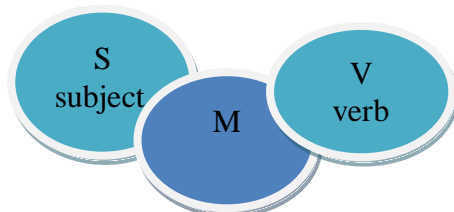
**Need - → necessity, importance, desirability.**

**Dare → challenge, courage, boldness, disapproval.**



**They are Auxiliary verbs that provide additional and specific meaning to the main verb of the sentence.**

**How do we use modals?:**



**Example: Mary could play the piano**



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\*They do not accept conjugation They do not need other auxiliary verbs.

**\*There is no “s” in singular There is no “do / does” in the question There is no “don’t / doesn’t” in the negative:**

He can ski He cans ski or He can skis

Would you like to come with me? **Do** you would like to come with me?

They **can’t** be serious They **don’t** can be serious

### Form:

Modal verbs do not have infinitives or –ing forms

**Modal verbs are followed by an infinitive without to :**

She must study (strong obligation)

We should have gone the other way (recommendation)

He could play football in his youth (ability in the past)

### Form :

Modal verbs do not have all the tenses

**Modal verbs use other verbs to complete the tenses**

\* Can is completed with be able to

\*Must is completed with have to

### Ex.:

They can play the piano

They will be able to play the piano in the future

You must come early

You had to come early yesterday

### What do they express? :

**They can have more than one meaning depending on the situations**

1. Single Concept Modal: they have one meaning
2. Double Concept Modal: they have two meanings
3. Modals in past: They are used to express a situation in the past



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### Modals in the Past :

**They are modals referred to actions that happened in the past**

MODAL + HAVE + verb in past participle

\*It must have been a difficult decision

\*They should have invited her to their wedding

#### **\*MUST HAVE + P.P.**

1. Logical conclusion on a past event Peter has arrived late.

Ex. He must have been in a traffic jam

#### **\*MAY / MIGHT HAVE + P.P.**

1. Deduction on a past event Joe

Ex. may / might have taken the wrong train.

#### **\*COULD HAVE + P.P.**

1. Possibility to do something, gone unfulfilled

Ex. You could have played better

#### **\*COULDN'T HAVE + P.P.**

1. Certainty that something couldn't have happened

Ex. He couldn't have passed because you hadn't studied enough

#### **\*WOULD HAVE + P.P.**

1. Desire to do something, but impossibility to do it for external causes

Ex. I would have visited you, but I forgot your address

#### **\*SHOULD / OUGHT TO HAVE + P.P.**

1. Lament on something that should have been done

Ex. You should / ought to have warned me earlier

#### **\*SHOULDN'T HAVE + P.P.**

1. Critique on something that shouldn't have happened

Ex. He shouldn't have told them



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(AFFILIATED TO SAURASHTRA UNIVERSITY)

3- Vaishalinagar  
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Raiya Road, Rajkot – 360001  
Ph. No–(0281)2471645

2 – Vaishalinagar  
Nr. Amrapali Railway Crossing  
Raiya Road, Rajkot - 360001  
Ph.No–(0281)2440478, 2472590

### \*NEEDN'T HAVE + P.P.

1. Something that wasn't necessary doing

Ex. You needn't have bought it .

### Modals-like verbs:

\*A few verbs which often serve as modals too. They need to be conjugated.

<u>MODEL</u>	<u>CONCEPT</u>	<u>EXAMPLE</u>
Like to	Enjoy	I like to watch TV
Want to	Desire	John wants to buy a car
Need to	Necessity	We really needed to talk to you
Have to	Obligation	Susan had to pay the rent
Have got to	Have to	I've got to go now
Look forward to	Future plan	I look forward to seeing you again

Modals [verbs](#) are different from normal [English verbs](#).

We use modal verbs to express different meanings and reach different purposes.

Modal verbs do not take an 's' for the third person singular.

She **musts** walk her home everyday. (wrong)

She **must** walk her home everyday. (correct)

After 'can', 'could', 'may', 'might', 'shall', 'should', 'ought to', 'will', 'would', 'must', 'have to', we use a bare infinitive (i.e. an infinitive without 'to').

We do NOT use a past form of a verb nor an **-ing** form.

I **could to** swim when I was nine. (wrong)

I **could swim** when I was nine. (correct)

The infinitive can be active. When necessary, it can be passive.



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For example:

The robbers **may be caught** soon.

Your money **may be found** soon.

I think this radio **can be repaired**.

### Can/Could

Ability: Birds can fly. I **can** swim

Permission: Yes, you **can** go to the cinema.

He **could** ride my car, if he let me know earlier.

### May/Might

Permission: You **may** see your friends now.

Possibility: It **may** snow tomorrow.

She **might** be really sick.

### Shall/Should/Ought to

Future actions: We **shall** visit again next time.

Responsibility: They **should** bring their [books](#) to school.

You **ought** to ask for your father's permission.

### Will/Would

Future Actions: She **will** join our team next month.

Imagination: I **would** call Mary if I remember her number.

### Must/Have to

Necessity: Human **must** eat.

Obligation: You **must** hand in your homework on time.

I **have to** help my mother tomorrow.