NTA(UGC)/NET/ SET/JRF

ASCENDANCE ACADEMY

PAPER ONE (For all subject codes)
PAPER TWO (Commerce & Management)

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MBA (Finance), JRF in Management, Commerce, HRM & Labour Welfare and Political Science

"If pursued diligently and persistently, Ascendence Academy notes will surely facilitate learning and help aspirants expand their horizons of knowledge to apply during exams and get closer towards achieving their goal by qualifying in exams"

Prof .Geeta Bhatia (M. Com, B.Ed, M. Phil, UGC NET)

BUSINESS MANAGEMENT

Management

Management is defined for conceptual, theoretical and analytical purposes as the process by which managers create, direct, maintain and operate purposive organization through systematic, co-ordinated co-operative human effort."   ------ *Mc Farland*

Management is the art of securing maximum results with a minimum of efforts so as to secure maximum prosperity for the employer and employee and give the public the best possible service."

"Management is the art of getting things done".------Mary Parker Follett

Management is both, a science as well as an art. It is an in exact science. However, its principles are of universal application.

Evolution of Management	
Approaches	***Represented by***
1. Early classical (focus on structure)	✓ Scientific management ✓ Administrative management ✓ Bureaucracy
2. Neo-classical (focus on people)	✓ Human relations movement ✓ Behavioural approach
3. Modern (focus on decision-making)	✓ Quantitative approach ✓ Systems approach ✓ Contingency approach

Henry Fayol's fourteen Principles of Management

(Remember Acronym: I DECODE USSR USA)

1) **Initiative:** Managers should allow employees to be innovative and creative.

2) **Division of labour:** Job specialization and the division of labour should increase efficiency, especially if managers take steps to lessen workers' boredom. It is applied to both technical and managerial kinds of work.

3) **Equity:** All organizational members are entitled to be treated with justice and respect.

4) **Centralization:** Authority should be concentrated at the top of the chain of command.

5) **Order:** The arrangement of organizational positions should maximize organizational efficiency and provide employees and the organization a conducive environment.

6) **Discipline:** Managers need to create a workforce that strives to achieve organizational goals.

7) **Esprit de corps:** Manager should encourage the development of shared feelings of comradeship, enthusiasm or devotion to a common cause.

8) **Unity of command:** An employee should receive orders from only one superior.

9) **Stability of tenure of personnel:** Long-term employees develop skills that can improve organizational efficiency.(job security + promise of growth)

10) **Subordination of individual interests to the common interest:** Employees should understand how their performance affects the performance of the whole organization

11) **Remuneration of personnel:** The system that managers use to reward employees should be equitable for both employees and the organization.

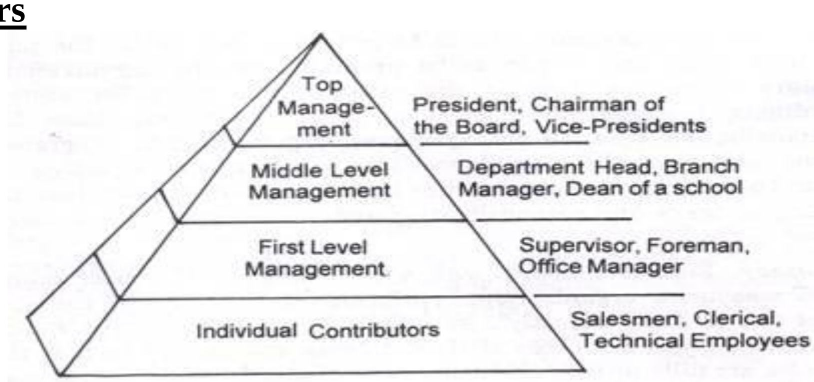
12) **Unity of direction:** The organization should have a single plan of action to guide managers and works.

13) **Scalar chain:** is the chain of supervisors ranging from the ultimate authority to the lowest ranks for the purpose of communication. Quick and easy communication within the organization is possible by using "Gangplank" or direct contact to prevent the delay of action.

Scalar chain

14) **Authority and responsibility:** Managers have the right to give orders and the power to exhort subordinates for obedience.

- **<u>Types of Managers</u>**



1. **First Line Managers:** They are often called supervisors and are found in all departments. Their primary concern is the application of rules and procedures to motivate subordinates give instructions and achieve results. The lower (or first line) management group is made up of foreman and white collar supervisors.

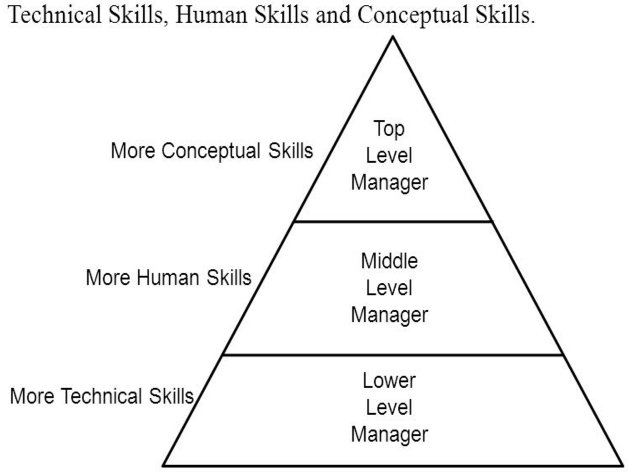
2. **Middle Managers:** They are ubiquitous (found in every organization) and head various departments in the organization. They are responsible for evaluating whether the goals of the organization are pursuing and for suggesting to executives ways in which goals should be changed. Middle level management includes sales managers, plant managers, personnel managers and many other department heads.

3. **Top Managers:** They set organizational goals, define strategies to achieve them, monitor and interpret the environment, make decisions that impact the entire organization. Top management consists of board chairman, the company presidents, the executive and vice-presidents.

- **<u>Skills of Manager:</u>**

  A skill is an individual's ability to translate knowledge into action. Skill is not necessarily inborn. It can be developed through practice and through relating learning to one's own personal experience and background.

▪ According to Robert L. Katz, there are three types of managerial skills, i.e. Technical Skills, Human Skills and Conceptual Skills.



- **<u>Robert Katz (HTC Skills):</u>**

1. **<u>Human skills/Interpersonal</u>** *(Middle level employee needs)*

   It involves ability to interact effectively with people, to motivate and direct individuals or groups of any level. It includes the ability to communicate, empathise, motivate and lead subordinates for better performance.

2. **<u>Technical Skills</u>** *(Lower level employee needs)*

   It involves process or technique knowledge and proficiency to carry out specific task. It deals with things and is to know the mechanics of the jobs

3. **<u>Conceptual Skills</u>** *(Top level management needs)*

   It refers to the ability of a manager to have a holistic picture about the organization. It involves formulation of ideas and requires ability to understand degree of complexity in a given situation and reduce that complexity to a level which specific courses of action can be derived. It deals with ideas.

- **Roles of Manager:** A role is a set of specific tasks that a person is expected to perform, because of the position he or she holds in an organization.

1. Interpersonal roles: These are necessary in order to coordinate and interact with employees, provide them direction and offer instructions.

✓ Role of a Figurehead (Symbolic duties),
✓ Leader (Motivate subordinates),
✓ Liaison (Maintaining contacts outside organisations).

2. Informational roles: Managers relate these roles to obtain and transmit information.
Manager acts a:
✓ Monitor (collecting and analysing information),
✓ Disseminator (transmitting information), and
✓ Spokesperson (transmitting information inside to outside).

3. Decisional roles: Managers use it to plan strategies and utilise resources and he needs to be:
✓ Entrepreneur (Initiating and Adapting change to environment,
✓ Disturbance handler (dealing with events),
✓ Resource allocator (decision on use of resource in organisations),
✓ Negotiator (at individual level, organisational level).

Motivational Theory	Description
I. Content Theories	Focus on identifying people's needs in order to understand what motivates them
1. Needs Hierarchy	Maslow's theory of motivation s based on five needs: Physiological Needs, Safety Needs, Social/Belonging and Love Needs, Self-esteem and Self-Actualization
2. ERG Theory	Alderfer's classification of needs is as: Existence, Relatedness and Growth
3. Two-Factor Theory	Herzberg's classification of needs as hygienes and motivators
4.Manifest Needs Theory	McClelland's classification of needs as achievement (nAch), power (nPow) and affiliation (nAff)
II. Process Theories	Attempt to understand how and why people are motivated.
1. Expectancy Theory	Vroom's formula: Motivation= Expectancy x Instrumentality x Valence
2. Equity Theory	Adam's motivation theory is based on the comparison of perceived inputs to outputs.
3. Goal setting Theory	Set realistic, attainable and time-bound goals performance takes place
4. Porter and Lawler's model	Seeks to identify valences and expectancies and link effort with performance and satisfaction.

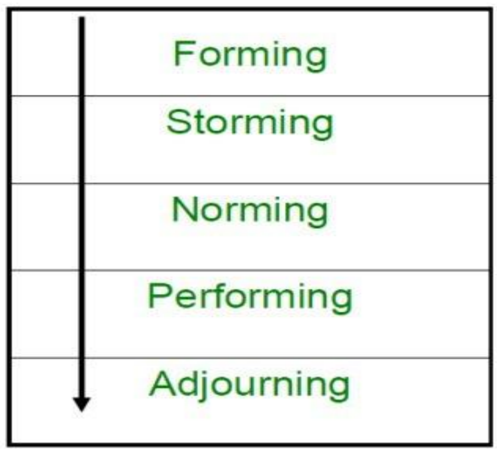
- **<u>Group dynamics</u>**

It was popularised by Kurt Lewin in 1930s.
It is concerned with interactions and forces among group members in a social situation.
Group dynamics means the action of a group engaged in a common endeavour.

<u>Stages of group development</u>

The most widely accepted five stages of group development are ones as reported by Bruce .W. Tauchman and M.A. Jensen.

<u>Stages of Group Development</u>



Stages of Group Development	Description
I. Forming	Members get to know each other and seek to establish ground rules. *(Awareness, Commitment, Acceptance)*
II. Storming	Members come to resist control by group leaders and show hospitality. *(Conflict, Clarification, Belonging)*
III. Norming	Members work together, developing close relationship and feeling of camaraderie. *(Co-operation, Development, Support)*
IV. Performing	Group members work towards getting their jobs done. *(Productivity, Achievement, Pride)*
V. Adjourning (Was added later)	Group may discard either their goals or members leave. *(Separation, Recognising, Satisfaction)*

<u>Stages of Group Development</u>

1) <u>Forming</u>: There is a great deal of uncertainty about group's purpose, structure and leadership. Members are concerned about exploring friendship and task potentials. They do not have a strategy for addressing the group's task. Leader's role is prominent and he is focused.

2) <u>Storming</u>: At this stage, conflict arises because of the need to clarify roles and behavioural expectations. Team member attempt to establish themselves in relation to other team members.

3) <u>Norming</u>: At this stage, a single leader emerges and this may bring about group cohesion. There is a strong sense of group identity and friendship. Norms, rules and regulations regarding the members' duties and responsibilities are made clear and accepted.

4) <u>Performing</u>: This stage is marked by teamwork, role clarity and task accomplishment. Group energy moves from a conflict to task accomplishment. Productivity is at its peak. Team has a shared vision and is able to stand on its own feet with no interference or participation from the leaders.

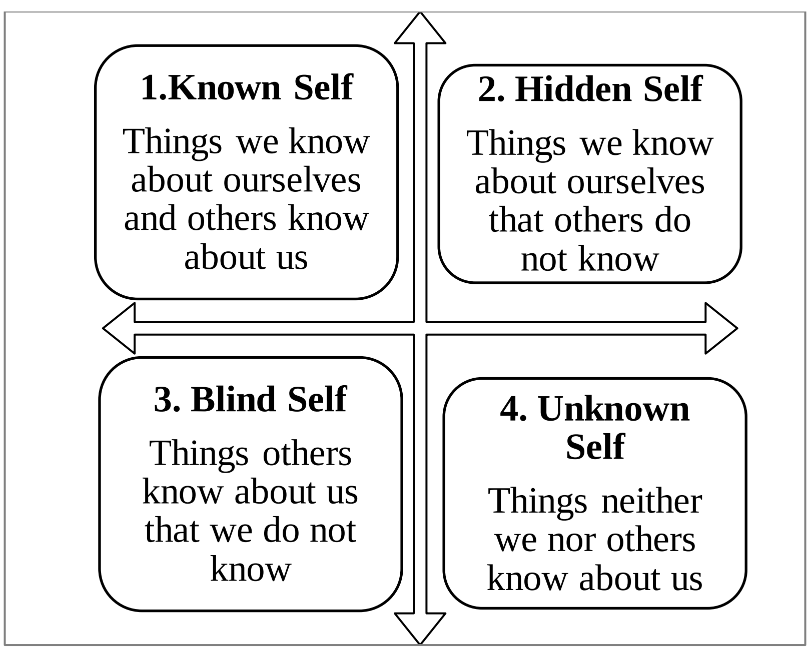
5) <u>Adjourning</u>: This stage happens to be the last stage for the groups which have specific tasks to perform. These groups disband on after achievement of the task.

Situational Leadership	***Similar to***
Forming	Telling mode
Storming	Selling mode
Norming	Participating Mode
Performing	Delegating Mode.

- **<u>Johari Window</u>**

✓ It was developed by Joseph Luft and Harry Ingham.

✓ This model is highly useful in analysing the causes for inter-personal conflict. The model is based on two assumptions:
(1) Degree to which the person knows about himself or herself.
(2) Degree to which the person is known to others.



The "Johari Window"

	Known to Self	Unknown to Self
Known to Others	**1. Free and Open** You know and others know (The areas of your life that are the so-called open book)	**2. Blind Self** You don't know but others do (The blind spots-we all have them)
Unknown to Others	**3. Hidden Self** You know but others do not (The things you know about yourself but will not share with others)	**4. Unknown Self** You don't know and others don't know (Nobody knows) (The things about you that no one knows, not even you)

1. **Open area:** This area consists of details known to self and to others. Mutual understanding and friendship between people are the highest in this area. There is little or no scope for conflict.

2. **Hidden self:** This area comprises the knowledge about self but is hidden from others. Overtime, lack of sharing can lead to distrust and miscommunication. This area has potential for inter-personal conflict.

3. **Blind area:** This area encompasses certain things about the person that are known to others but not to self. There is scope for inter-personal conflict.

4. **Undisclosed self:** This area contains information unknown to self and unknown to others. It has high potential for conflict.

Stroking: It refers to recognition of one's presence by others. Strokes may be positive or negative.
Positive stroke: makes one feel cheerful. Eg: recognition, pleasant smile, etc.
Negative strike: makes one feel sad. Eg: criticism, hatred, etc.

Life Positions: are acquired by us at early stage and are generally endure. They influence our behaviour.

Positive	I am OK- you are not OK.	I am OK- you are OK.
Negative	I am not OK- you are not OK.	I am not OK- You are OK.
	Negative	Positive

Attitude towards others

Note: Of the four life positions, the ideal one is I am OK, You are OK. It shows healthy acceptance of self and others.

Conflict Table

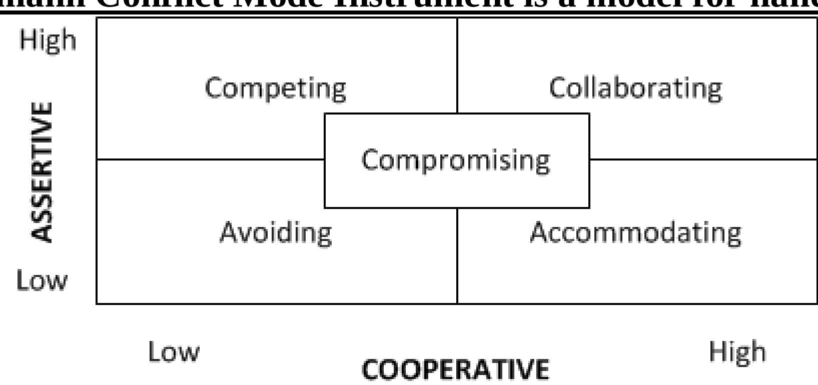
	I win	I lose
You win	Win-Win	Lose-Win
You lose	Win-Lose	Lose-Lose

3. <u>Intra group conflict:</u> refers to disputes among some or all of a group's members, which often affect the group's performance.

4. <u>Inter group conflict:</u> also called organizational conflict. It refers to the conflict between groups, departments or sections in an organization. The reasons for inter group conflict may be:

- Task inter dependence
- Task ambiguity
- Goal incompatibility
- Competition for limited resources
- Competitive reward systems
- Line and staff
- Intra-personal and Inter-personal conflict

<u>Thomas-Kilmann Conflict Mode Instrument is a model for handling conflict.</u>



Conflict Management Style	**Explanation**	**Comparison**
1. Competing	Forcing a solution to impose one's will on the other party	Shark (Tough battler - Fighting)
2. Avoiding	Denying the existence of conflict and hiding one's true feelings.	Turtle (Impersonal compiler-Withdrawing)
3. Compromising	Bargaining for gains and losses to each party.	Fox (Conciliator- Negotiating)
4. Accommodating	Playing down the conflict and seeking harmony among parties	Teddy-bear (Friendly helper- Self-Sacrificing)
5. Collaborating	Searching for solution that meets each other's needs.	Owl (Problem solver-Mutual problem solving)

BUSINESS ENVIRONMENT

- **Environment** refers to all external forces which have a bearing on the functioning of business.

- **Business environment:** "The sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but the business still depends upon them as they affect the overall performance and sustainability of the business."

Business organization is a microeconomic unit influenced by its environment-economic and non-economic, internal and external.

Nature of Business Environment is explained by the following approaches:

(i) System Approach: In original, business is a system by which it produces goods and services for the satisfaction of wants, by using several inputs, such as, raw material, capital, labour etc. from the environment.

(ii) Social Responsibility Approach: In this approach business should fulfill its responsibility towards several categories of the society such as consumers, stockholders, employees, government etc.

(iii) Creative Approach: As per this approach, business gives shape to the environment by facing the challenges and availing the opportunities in time. The business brings about changes in the society by giving attention to the needs of the people.

Elements of Business Environment		
Internal Environment	**External Environment**	
• Plans and Policies • Human Resources • Financial Resources • Corporate Image • Plant and Machinery • Labour Management • Relationship • Promoters'/Shareholders' values	***Micro Environment*** • The customers • The competitors • The suppliers • Publics (Society) • Financiers • Marketing intermediaries	***External Environment*** • Demographic • Economic • Technological • Political • Social/Cultural • Global

Factors that affect a business environment

Internal environment	**External environment**		
	Microeconomic	**Macroeconomic**	
Management structure	Input suppliers	Demand-price	
Stakeholders	Workers and unions	Savings/Investment	
Relationships	Customers	Monetary/Fiscal	
Technology resources	Marketing intermediaries	Balance of payments situations	
Human resources	Competitors and public	Overall growth activity	
Financial resources		**Economic**	**Non-economic**
Firm's goals and objectives		Economic system	Political-legal
Value system		Macroeconomic scenario	Socio-cultural
		Financial system	Natural
		Economic policies	Demographic
		Economic legislations	Macroeconomic variables
		Economic planning	

- **Competition Act 2002:**

The MRTP Act, 1969 had become obsolete and was choking the economy. Therefore, it became imperative to enact a Competition Act to replace the outdated MRTP Act.
It is a specific law which got passed in 2002 and called the Competition Act. It extends to the whole of India except Jammu and Kashmir. The act was amended in 2007 and then again in 2009 by the Competition (Amendment) Act to make it more effective. The Competition Act seeks to promote and sustain competition to protect the interests of consumers and ensure freedom of trade. Competition Act was conceived in tune with the recommendations of the Raghavan Committee.

The Competition Act is important for businesses in three main areas:

✓ Commercial agreements and trading practices
✓ Conduct towards competitors, suppliers and customers, especially in the case of firms with a strong market position
✓ Mergers and acquisitions

Objectives of Competition Act, 2002

1. To establish commission to prevent practice having adverse effect on competition.
2. To promote and sustain competition in market.
3. To protect interest of consumers
4. Freedom to carry trade by participants in market
5. To prevent abuses of dominant position in the market activity

6. To regulate operation and activities of combinations (Acquisitions, Mergers and Amalgamation)
7. To create awareness and impart training about competition Act

The basic objectives of the competition Bill that is designed replace the MRTP Act are:

(i) Encourage competition
(ii) Prevent abuse of dominant position
(iii) Protect the consumer
(iv) Ensure a level playing field to participate in the Indian economy.

Competition Act is not applicable to:

1. Public Financial Institutions
2. Foreign Financial Investors (FIIs)
3. Banks
4. Venture Capital Funds (VCFs)
5. Agreements related to Intellectual Property Rights (IPRs) i.e., Trademarks, Patents, Copyrights, etc.
6. Central government has authority to exempt any class of enterprises from provisions of Act in common interest of national security or public interest

Main features of Competition Act, 2002

The act prohibited following behaviours:

1) **Anti – competitive agreements (Sec-3)/Agreement amongst enterprise**

- Those agreements which restricts competition
- Agreements can be between producers and distributor
- Agreements can be between producers and supplier
- Agreements can be directly/indirectly control prices of products and services in the market.
- Agreement may lead to bidding/rigging.

The Act deals only with those agreements between enterprises, which have an appreciable adverse effect on competition. This means that all restrictive agreements are not held to be anti-competitive.

As per this provision, no person or enterprise or group shall enter into an agreement that causes adverse effects on competition within India in respect of production, supply, distribution, storage, acquisition or control of goods or rendering of services.

2) **Abuse of dominant position(Sec-4)**

- Prevents parties to abuse their dominant status in the market
- These Positions are that of power and strength.
- Dominant party has power and resources to control process of any goods and services without even needing to consult its rivals

The Act regulates all agreements, which could result in abuse of dominance. The enterprise should be “dominant” and the agreement should have resulted in “abuse” of the dominance.

3) Mergers, Amalgamation and Acquisitions Control (Combination) (Sec-5)

- It ensures no acquisition or amalgamation occurs which may likely have an adverse effect on other competitors in the market.
- It covers acquisition of Control, Shares, Voting Rights and assets, though there are many factors which need to be looked into before deciding violations of any clause.

The Act regulates all mergers, which create a position of dominance post-merger. It is understood that the government would make pre-merger notification, if required, voluntary. It also provides for a deemed approval of a merger in the absence of a response from the CCI within a period of 90 days.

As per the provision, no enterprise or group of enterprises shall form a combination in the relevant Indian market. If such a combination was effected, it will be held illegal.

Monetary policy	**Fiscal policy**
It aims to attain full employment by offering credit at an affordable cost.	It tries to achieve full employment through fiscal incentives, subsidies, etc
The objective of monetary policy is to maintain price stability, full employment and economic growth.	The objective of fiscal policy is to change aggregate demand, to control inflation and overcome recession.
The monetary policy regulates money supply and the cost and availability of credit. It also influences lending and borrowing rates of commercial banks.	It causes a deliberate change in government revenue and expenditure with a view to influencing the price level and the quantum of national output.
It is formulated and implemented through the central bank.	It is through the treasury or the ministry of finance.
It is the policy statement announced twice a year by the RBI along with an economic overview and future forecast.	It is showcased by the union budget announced on the last day of February every year, preceded by an economic survey.

- **Company** is an important form of ownership, also called a corporation. Company is an artificial and invisible being recognized by law and created to pursue business objectives.

Company formation: involves three stages, viz.; (a) registration (b) capital raising and (c) commencement of business.

***I.* Promotion stage**	***II.* Incorporation stage**	**III. Subscription stage**	**IV. Certificate of commencement**
• Idea • Investigation • Assembling of factors • Financial resources • Essential documents	• Submission of application • Payment of registration fee • Verification of application • Certificate of incorporation	• Raising capital	• Issue of prospectus • Allotment of shares • Minimum subscription

- **Companies Act, 2013**

The Indian Companies Act, 2013 replaced the earlier act of 1956. This is landmark legislation and governs both listed and unlisted companies in India.

Indian Companies Act, 1956	Companies Act, 2013
✓ 13 parts	✓ Parts not applicable
✓ 26 chapters	✓ 29 chapters.
✓ 658 Sections	✓ 470 Sections.
✓ 15 schedules	✓ 7 schedules
✓ Maximum number of shareholders was 50.	✓ Maximum No. of shareholders is 200. Section 2(68)
✓ Maximum 12 Directors	✓ Maximum 15 Directors Section 149(1).
✓ Financial year ending on a date decided by company.	✓ Financial year ending on 31st March, every year. Section 2(41).
✓ One (OPC) person company did not exist.	✓ One (OPC) person company exist. (One natural person as member)
✓ Section 79, permitted issue of shares @ discount.	✓ Section 53 prohibited issue of shares @ discount. However Sec.54 permits issue of ESOPs to its employees @ discount.
✓ Utilisation of securities premium Reserve was provided in Sec 77A and 78.	✓ Utilisation of securities Premium Reserve is provided for in section 52 (2).
✓ 10 partners in banking ✓ 20 in other business	✓ Current 50, but as per rules subject to maximum 100.
✓ Table 'A' applied where companies did not adopt their own AOA.	✓ Table 'F' applies where companies ltd. By shares do not adopt their own AOA.
✓ In absence of clause in AOA, maximum interest *1.* <u>Chargeable</u> on calls-in- arrears was 5% p.a *2.* <u>Payable</u> on calls-in-advance was 6% p.a.	✓ In the absence of clause in AOA, maximum interest *1.* Chargeable on calls-in-arrears is 10% p.a. *2.* Payable on calls-in-advance is 12% p.a.
✓ Section-69 requirement of minimum subscription was with respect to shares only.	✓ Section-39, a company shall not allot securities unless the amount stated in prospectus as minimum subscription has been subscribed and sum paid.

- **Consumer Protection Act, 1986**

Consumer protection refers to the steps necessary to be taken or measures required to be accepted to protect consumers from business malpractices. It may e regarded as a movement like consumerism.

On 15 March, 1962, President John. F. Kennedy declared before the US Congress the four rights of consumers- rights to satisfaction of basic needs, right to safety, right to be informed and right to choose. Since then, 15 March is celebrated as the World Consumer Rights Day every year.

- Received assent of President on 24th December and came into force on 15 April 1986.
- It provides consumer with Speedy and inexpensive redressal of grievances mechanism and specific relief or award of compensation.
- Act aims to provide consumers with effective safe guards against different types of exploitation such as:
- Defective goods
- Unsatisfactory services
- Unfair trade practices.
- Extends to whole of India except Jammu and Kashmir.
- Shall apply to all goods and services.

This Act (COPRA) is applicable to all defective goods and deficiency in service.

"Goods, under the act mean every kind of movable property, including stocks and shares, growing crops attached to or farming part of the land.

<u>"Service"</u> means service of any description which is made available to potential users including facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or other information.

"**<u>Consumer"</u>** means any person who buys or hires any services for some consideration, paid or promised and includes any other user of goods r services using them with the approval of the buyer. It does not include a person who obtains goods for any commercial purpose for resale.

1. **The Right To Safety**
2. **The Right To Choose**
3. **The Right To Information**
4. **The Right To Be Heard**
5. **The Right To Redressal**
6. **The Right To Consumer Education**
7. **The Right For Basic Needs**
8. **The Right For Healthy Environment**

NOTE: Rights number 7 & 8 have been added by the amendment in the act in 1993 and 2002 respectively.

<u>Rights of Consumer Under the Act</u>

1. **Right to safety:** The right to be protected against the marketing of dangerous and injurious products. e.g. lead ridden Maggi

2. **Right to information:** The consumer has the right to be informed about the quality, potency, purity, standard and price of goods or services. Eg: ingredients, veg/non-veg, calories related data.

3. **Right to be heard:** Right to make complaints against quality issue of the product to the company itself.

4. **Right to consumer education:** Right of consumer to be aware about the various rights available to him as a consumer.

5. **Right to choose:** Right to choose from various alternatives and not to be forced to choose a particular product.

6. **Right of Redressal of Grievances:** Right to approach District, State and National forum for Redressal of Grievances.

Consumer Redressal Forum: To provide relief to consumers and to safeguard interest of consumers and it's a three tier mechanism to protect the rights of consumers.

1. **District Level**

✓ District Consumer Redressal Forum.
✓ Headed by a judicial officer equivalent to sessions judge and he is assisted by 2 members.
✓ Cases involve compensation upto 20 Lakhs are entertained.

Appeals against forum's orders: Appeal against the order of the District Forum can be filed with the State Commission within 30 days of passing the order.

2. **State Level**

✓ State Consumer Redressal Commission.
✓ Headed by Judicial officer equivalent to High Court Judge and has 2 members.
✓ Cases involve compensation of 20 lacs to 1 crore are entertained.

Appeals against forum's orders: Appeals against the orders of the commission (except on appeals against the orders of a District Forum) can be filed in the National Commission within 30 days of the order.

3. **National Level**

✓ National Consumer Dispute Redressal Commission.
✓ Headed by judge of Supreme Court and has 4 members.
✓ Cases involve compensation above 1 crore are entertained.
✓ Supreme Court is the final deciding authority in case of appeals coming from State Commissions of various states.

Appeals against forum's orders: Appeals against the orders of the National Commission can be filed in the Supreme Court within 30days of its order.

Eligibility to file a claim: The eligibility to file a claim against the seller or manufacturer is vested on a consumer who is described as any person who:

✓ Has bought goods for a consideration and finds any defect in the quality, quantity, potency, purity or standard of the goods; or

✓ Has hired or availed any service for consideration and finds any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance in relation to the service can approach.

Note: However, if a person has bought the goods for resale or for a commercial purpose he is not a consumer.

Limitations and Appeals

A complaint can be filed at the earliest but not later than TWO YEARS from the date on which the cause of action arose. However, the court may entertain the complaint after a period of 2 years if the complainant is able to satisfy the court that there was sufficient cause for the delay.

Appeals

All appeals are to be filed within 30 days of the order appealed against and are to be accompanied by a certified copy of the order.

The Three-Tier Redressal System in India

The objective of the system is to provide cheap and quick redressal of consumer grievances at the appropriate level with minimum technicalities and legal formalities.

The complaint can be filed by an individual consumer, a recognized association of consumers or by a state or central government.

- **Micro, Small and Medium Enterprises (MSMEs)** previously called small-scale industries (SSIs). SMEs are now being categorized into micro, small and medium enterprises all broadly classified into manufacturing and service sectors. The investment limits are as follows:

Manufacturing sector	In terms of investment in plant and machinery
Micro	Does not exceed Rs. 25 lakh
Small	More than Rs.25 lakh but does not exceed Rs. 5 crore
Medium	More than Rs. 5 crore but does not exceed Rs. 10 crore

Service sector	In terms of investment in equipment
Micro	Does not exceed Rs. 10 lakh
Small	More than Rs.10 lakh but does not exceed Rs. 2 crore
Medium	More than Rs. 2 crore but does not exceed Rs. 5crore

- **Intellectual Property Rights:** IPR is the body of law developed to protect the creative people who have disclosed their invention for the benefit of mankind. This protects their invention from being copied or imitated without their consent.

✓ Intellectual Property Rights (IPRs) refers to the legal ownership of by a person or business of an invention/ discovery attached to a particular product/ process which protects the owner against unauthorized copying or limitation.

✓ IPR is thus a common term encompassing patents, copyright, trademark, industrial designs, geographical indications, protection of layout design of integrated circuits and protection of undisclosed information (trade secrets).

Intellectual property rights are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time. Therefore, one important feature that requires note is that the right is not perpetual.

The World Trade Organization classifies the IP broadly into two main parts namely copyright and rights related to copyright and industrial property.

(i) Copyright and rights related to copyright:

The rights of authors of literary and artistic works (such as books and other writings, musical compositions, paintings, sculpture, computer programs and films) are protected by copyright, for a minimum period of 50 years after the death of the author.

Also protected through copyright and related (sometimes referred to as "neighbouring") rights are the rights of performers (e.g. actors, singers and musicians), producers of phonograms (sound recordings) and broadcasting organizations. The main social purpose of protection of copyright and related rights is to encourage and reward creative work.

(ii) Industrial property:

Industrial property can usefully be divided into two main areas:

- One area can be characterized as the protection of distinctive signs, in particular **Trademarks** (which distinguish the goods or services of one undertaking from those of other undertakings) and **Geographical Indications** (which identify a good as originating in a place where a given characteristic of the good is essentially attributable to its geographical origin).

According to WTO, the protection of such distinctive signs aims to stimulate and ensure fair competition and to protect consumers, by enabling them to make informed choices between various goods and services. The protection may last indefinitely, provided the sign in question continues to be distinctive.

- Other types of industrial property are protected primarily to stimulate innovation, design and the creation of technology. In this category fall inventions (protected by **Patents), Industrial Designs and Trade secrets.**

The social purpose is to provide protection for the results of investment in the development of new technology, thus giving the incentive and means to finance research and development activities.

- A functioning intellectual property regime should also facilitate the transfer of technology in the form of foreign direct investment, joint ventures and licensing.
- The protection is usually given for a finite term (typically 20 years in the case of patents).
- WTO claims that the exclusive rights given are generally subject to a number of limitations and exceptions, aimed at fine-tuning the balance that has to be found between the legitimate interests of right holders and of users, such that the social objectives are kept in mind besides the economic interests.

The Legislative Framework

Several legislative initiatives have been taken by the Indian Government for complementing the administrative set up for IPR. These are:

- ✓ Trademarks Act, 1999
- ✓ The Geographical Indications of Goods (Registration and Protection) Act, 1999
- ✓ The Designs Act, 2000
- ✓ The Patents Act, 1970

- **Indian Patent Act:** In India, the grant of patents is governed by the Indian Patent Act, 1970 and Rules 1972. The patents granted under the act are operative in the whole India.

Patent: is a grant from the government which confers on the guarantee for a limited peiod of time the exclusive privilege of making, selling and using the invention for which the patent has been granted. It is a limited legal monopoly granted to an individual or firm to make, use and sell its invention, and to exclude others from doing so.

Purpose of getting a patent

- ✓ To enjoy the exclusive rights over the invention.
- ✓ To ensure commercial returns to the inventor for the time and money spend in generating a new product.

What can be patented?

In order to be patentable, an invention must pass through four tests:

1. It must fall into five 'statutory classes':

a) Process: chemical, mechanical, electrical or other process that produces a chemical or physical change in the condition or character of an item.

b) Machine: apparatus or device with interrelated parts that work together to perform the invention's designed or intended functions.

c) Manufacture: all manufactured or fabricated items

d) Composition of matter: chemical compounds or mixtures having properties different from their constituent ingredients.

e) New uses of any of the above

2. Invention must be 'useful'.

3. Invention must be novel.

4. Invention must be 'non-obvious'.

Salient features of Patent-Law

- ✓ Both product and process patent provided
- ✓ Term of patent-20 years
- ✓ Examination on request
- ✓ Both pre-grant and post-grant opposition
- ✓ Fast track mechanism for disposal of appeals
- ✓ Provision for protection of bio-diversity and traditional knowledge.

Safety in Patent Law

a) Compulsory license to ensure availability of drugs at affordable prices.
b) Provision to deal with public health emergency
c) Revocation of patent on public interest and also on security considerations.

Rights of a patentee

1) **Right to exploit the patent:** Patentee has a right to prevent third parties from exploiting the patented invention.

2) **Right to grant licence:** The patentee has a power to assign rights or grant license.

3) **Right to surrender:** The patentee is given the right to surrender the patent by giving notice in prescribed manner to the controller.

4) **Right to sue for infringement:** A patentee is given the right to institute proceeding for infringement of the patent in a district court.

Term of Patent

In respect of an invention claiming process of manufacture of a substance intended to be used as food or medicine- 5 years from the date of selling or 7 years from the date of patent whichever is shorter. In case of any other invention- 14 years from the date of patent.

- **Invention:** means a new product or process involving an inventive step and capable of industrial applications.

  In India, some inventions are not patentable:

(i) Invention which is frivolous or which are prejudiced to human, animals or plant life. Eg: Gambling machine.
(ii) Discovery: is something adds to human knowledge by disclosing something not seen before, whereas invention adds to human knowledge by suggesting an act which results on new products or processes. Eg: Archimedes principle, superconducting phenomenon- not patentable, nut an apparatus/method for technological application is patentable.
(iii) Mere discovery of a new form of a known substance which does not lead to enhancement in efficacy of that substance is not patentable.

- **Trademark:** is a distinctive sign which identifies goods and services of the company from those of others. It helps identify and distinguish between products and services. It is typically a name, logo, word, phrase, symbol, design or combination of these elements. There are also unconventional trademarks those based on colour, smell or sound.

The proprietor of a trademark has a right to file a suit for infringement of his right and obtain: injuction, damages, account of profits.

- Trademark- TM (For unregistered trademark used to promote or brand goods) valid for 10 years.
- Service Mark- SM (For an unregistered service mark) valid for 17 years.
- Registered- R (For a registered trademark)

- **<u>Copyright:</u>** is a legal term describing rights given to creators for their literary and artistic work.

The Copyright Act, 1957 along with the Copyright Rules, 1958 is the governing law for copyright protection in India. Copyright laws protect the legal rights of the creator of an 'original work' by preventing others from reproducing the work in any other way.

Copyright deals with:

(i) Novels, poems, plays, newspapers.
(ii) Databases
(iii) Paintings, drawings, photographs and sculpture
(iv) Architecture

- It does not cover: ideas, facts and blank forms
- Exceptions: Library and classroom

<u>Term of Copyright :</u>

<u>It lasts for:</u>

(i) Author's lifetime + 50 years from the end of calendar year in which author dies.
(ii) 50 years for films and recordings

<u>Other IPRs</u>

(i) <u>Geographical indications (GI):</u> Government of India as a member of WTO enacted Geographical Indications of Goods (Registration and Protection) Act, 1999 and came into effect on 15th September, 2003. Geographical indications is defined as indications which identify a good as originating in the territory of a member or region, where a given quality, reputation or characteristic of good is essentially attributable to its geographic origin". It ensures that none except those living in that territory are allowed to use the product name. In 2004-05, Darjeeling tea became first GI tagged product in India.

(ii) <u>Industrial designs:</u> Industrial designs are protected for a period of 10 years. Owners of protected designs would be able to prevent the manufacture, sale or importation of articles bearing or embodying a design which is a copy of the protected design for commercial purposes.

(iii) <u>Integrated circuits:</u> The TRIPs Agreement provides protection to the layout designs (topographies) of integrated circuits for a period of 10 years.

(iv) <u>Trade secrets:</u> Trade secrets and know-how having commercial value shall be protected against breach of confidence and other acts.

- **<u>Trade Related Investment Measures (TRIMs):</u>** It refers to certain condition or restrictions imposed by a Government in respect of foreign investment in the country. The TRIM text provides that the foreign capital would not be discriminated by the member Governments.

  <u>Features of TRIMs</u>

  1. Abolition of restriction imposed on foreign capital
  2. Offering equal rights to the foreign investor on par with the domestic investor
  3. No restrictions on any area of investment
  4. No limitation or ceiling on the quantum of foreign investment
  5. Granting of permission of without restrictions to import raw material and other components
  6. No force on the foreign investors to use the total products and or materials
  7. Export of the part of the final product will not be mandatory
  8. Restriction on repatriation of dividend interest and royalty will be removed

9. Phased manufacturing programming will be introduced to increase the domestic content of manufacturer

- **<u>Trade Related Intellectual Property Rights (TRIPs):</u>** was added to the General Agreement on Tariffs and Trade (GATT) treaty at the end of the Uruguay Round of trade negotiations in 1994

Intellectual property rights may be defined as “Information with commercial value”. IPR have been characterised as a composite of “ideas and creative expression”. Plus “ the public willingness to bestow the status of property. It include

a. Protection of patent
b. Copyright
c. Industrial design
d. Geographical indication
e. Trademarks f. Trade secrets
g. Layout design (topographies of integral circuits)

Indian Patent Act of 1970	TRIPs
Only process not product patents in food, medicines, chemicals	Process and product patents in almost all fields of technology
Term of patents 14 years; 5-7 in chemicals, drugs	Term of patents 20 years
Compulsory licensing and license of right	Limited compulsory licensing, no license of right
Several areas excluded from patents (method of agriculture, any process for medicinal surgical or other treatment of humans, or similar treatment of animals and plants to render them free of disease or increase economic value of products)	Almost all fields of technology patentable. Only area conclusively excluded from patentability is plant varieties; debate regarding some areas in agriculture and biotechnology
Government allowed to use patented invention to prevent scarcity	Very limited scope for governments to use patented inventions

INTERNATIONAL BUSINESS

❖ International business means business across the countries.

✓ It is a business that crosses national boundaries, involving transfer of goods, services, capital, knowledge and information to satisfy needs of individuals, organisations and governments.

✓ Business has profit motive and Government has service motive.

✓ International business has global outlook.

✓ International marketing involves identifying and satisfying wants of customers around world.

✓ International trade involves imports and exports.

✓ International business is a wider term than international marketing as International business includes International Marketing.

- **<u>Stages Of Globalisation/Internalization</u>**

  A company passes through different stages of development before it becomes a truly global corporation. **<u>O.Wheeler</u>** has identified five stages in the development of a firm into global corporation which are as follows:

1. Domestic Company → **2. International Company** → **3. Multinational Company** → **4. Global Company** → **5. Transnational Company**

1) <u>Domestic Company</u>

- ✓ Moves into new markets abroad by linking up with local dealers and distributors in the host country.
- ✓ It never thinks of growing globally. If it grows, beyond its present capacity, the company selects the diversification strategy of entering into new domestic markets.
- ✓ It does not select the strategy to expand or penetrate into international markets. It only exports. Eg.Tyre Manufacturers who sell their products through exports only.

2) <u>International Company</u>

- ✓ Domestic companies who decide to exploit opportunities in foreign countries are called international companies.
- ✓ They focus on domestic practices, but extend domestic business model and practices to the foreign markets.
- ✓ Follows ethnocentric approach (Top management is from foreign country) due to limited resources and to learn gradually from the foreign markets.
- ✓ They offer domestic marketing mix in international mix.

  For example, Starbucks offer similar marketing mix to each country in the world.

3) <u>Multinational Company</u>

- ✓ Follows different strategies for different markets (Multidomestic)
- ✓ International company becomes MNC when it starts responding to specific needs of foreign markets in terms of product, price and promotion.
- ✓ Follows polycentric approach (Top Management headed by domestic company).

For example, McDonalds is considered as an MNC as it offers different marketing mix to each country. For example, Beef is not served in India but “Aloo Tikki Burger” is served.

4) <u>Global Company</u>

- ✓ Produces either in home country or in a single country and focuses on marketing its products globally or produces the products globally and focuses on marketing these products domestically.
- ✓ MNC becomes global company when it adopts a global marketing strategy.

  For example, Dr Reddy’s Laboratories produce drugs in India and market its products globally.

5) **Transnational Company**

- ✓ Adopts a genuinely global mode of operation.
- ✓ Discards its nationalistic mindset and thinks globally but acts locally.
- ✓ TNC invests, produces, markets and operates across the world. There is no pure transnational corporation.
- ✓ Uses global resources for global markets.
- ✓ Provides good value to customers in all the countries where it does business.
- ✓ Assets and key operations (R & D, HRD, etc) are distributed worldwide.
- ✓ Follows geocentric approach (Top Management can be from any country). It thinks globally and acts locally.
- ✓ Adapts its various strategies to the needs of each market.
- ✓ Companies like Samsung, LG, Phillips, etc are all prominent examples of transnational companies.

❖ THEORIES OF INTERNATIONAL TRADE

Introduction: The first theory of international trade is known as **Mercantilism**, which advocated country should encourage exports and discourage imports and suggested government intervention in both exports and imports.

- ✓ In 1776 Adam Smith broke the myth of behind Mercantilism; he advocated free trade among nations for the welfare of all the countries.

- ✓ Smith argued that the invisible hand of market mechanism should decide what a country exports or imports rather than government.

- ✓ In 19th Century, David Ricardo advanced comparative advantage theory.

- ✓ Eli Heckscher and Bertil Ohlin coined factor endowment theory.

- ✓ Michael Porter gave National Competitive Advantage attributes i.e. Diamond of National Advantage.

- ✓ Adam Smith, David Ricardo and Heckscher – Ohlin advocate free trade.

- ✓ New Trade theory and theory of national competitive advantage justify limited government involvement to support growth of some exports oriented industries.

1) **Mercantilism** (England 16th Century)

- ✓ Merchantilism is the first theory of international trade.
- ✓ Suggested that the wealth of a nation consisted of gold and silver which were then the currency of trade between countries.
- ✓ *The Merchantilism theory suggests for maintaining favourable balance of trade in the form of import of gold for export of goods and services.*
- ✓ Country should increase its exports and decrease its imports to accumulate gold and silver through government interventions.

- ✓ By doing so country can maintain a surplus in balance of trade and maintain its power and prestige as a country which is economically strong is considered as politically more powerful.
- ✓ According to Merchantilsts, a nation's wealth and prosperity depend on its stock of precious metals which, in turn, was a function of trade surplus.
- ✓ Merchantilists viewed trade as a zero-sum game-trade (one's gain is the loss of another) wherein it is actually a positive –sum game.
- ✓ Adam Smith and David Ricardo criticised Mercantilism as it viewed trade as a **Zero-sum game**, wherein one country's gain is another country's loss. Thus, by accumulating gold and silver we are in a way increasing money supply which leads to inflation and increase in the cost of production and ultimately, the Country which has been the Net Exporter becomes the Net Importer. Hence, Mercantilism is not sustainable in the long run and must be abolished.
- ✓ In fact, trade according to Adam Smith and David Ricardo is a **positive sum game**, wherein all countries can gain from trade, hence they asked for removing restrictions from barriers to trade.
- ✓ However, Mercantilism is not dead, it has become <u>Neo-Mercantilism</u> (Something which was dead has come back again) Eg: After global recession of 2008 as many of the countries are **devaluing their currency** as a trade strategy of boosting exports and restricting imports. For Example, Donald Trump's Policy of America First is nothing but new form of Neo-Mercantilism.

2) <u>**Absolute cost advantage theory by Adam Smith**</u>

- ✓ Adam Smith opposed Mercantilism in his book **'The Wealth of Nations'** in 1776.
- ✓ According to him, free trade enables a country to produce a variety of goods and services.
- ✓ He argued that certain goods can be produced at a lower cost in one country than in another country.
- ✓ He states that a country should only produce what it specializes in and import what it doesn't specialize in.
- ✓ By specializing in production of goods in which each country had an absolute advantage, both countries could benefit by exchanging their surplus output.
- ✓ Trade is a positive sum game and every country benefits.
- ✓ Trade is not a zero game theory in which one country's gain is another country's loss.
- ✓ Output and consumption for both countries increase due to specialisation and international trade.
- ✓ International trade produces gains for countries involved in it.
- ✓ It mentions that in case a country specializes in the production of both commodities, then the country would not enter into international trade and would produce all the goods domestically only and export the surplus.

<u>Assumptions of absolute cost advantage theory</u>

1) Free trade is between two countries and only two commodities are traded.
2) Commodities are homogeneous and homogeneity of tastes.
3) Only labour cost of production is considered

The basis of international trade is difference in the absolute cost of production of different commodities between nations. According to Adam smith's theory of international trade, <u>three kinds of gains</u> accrue to a country from international trade:

a) Productivity gain
b) Absolute cost gain
c) Vent for surplus gain

3) <u>Comparative cost advantage theory by David Ricardo</u>

- ✓ David Ricardo removed the limitations of absolute cost advantage theory in his book **'Principles of Political Economy & Taxation'** 1817.
- ✓ Later, it was refined *by J.S.Mill, Marshall , Taussig and* others.
- ✓ He states that absolute cost advantage theory does not explain what happens when one country has an absolute advantage in production of all the goods.
- ✓ <u>David Ricardo's Theory of Comparative Cost Advantage</u> states that, it is beneficial for a country to specialize in the production of those goods that it produces most efficiently and to buy the goods that it produces less efficiently from other countries.
- ✓ It states that, free and unrestricted trade among nations encourage specialisation on a larger scale.
- ✓ A country's comparative cost advantage of a commodity is measured by the relative value of one commodity in terms of other commodity.
- ✓ It suggests that comparative advantage arises due to differences between productivity of labour in the two countries.
- ✓ It mentions that all countries can gain from international trade.

4) <u>Opportunity Cost Theoryby Gottfried Haberler</u>

- ✓ Gottfried Haberler gave a new life to the comparative cost theory by restating the theory in terms of opportunity costs in 1933.
- ✓ Opportunity cost is a refinement of the Ricardian theory, as logic behind both is the same.
- ✓ According to the opportunity cost theory, the basis of international trade is the differences between nations in the opportunity costs of production of commodities.
- ✓ It demonstrates that trade is beneficial as long as opportunity cost differs.
- ✓ It recognises the existence of many different kinds of productive factors, whereas Ricardo considered only labour.
- ✓ It tells that even if we discard the labour theory of value as being invalid and rely on opportunity cist, the comparative cost theory is still valid.

5) <u>Factor Endowment Theory by Eli Heckscher and Bertil Ohlin</u>

- ✓ Heckscher and Ohlin in their respective books ; The effect of Foreign Trade on the Distribution of Income and Interregional and International Trade state that comparative advantage results from differences in factor endowments.
- ✓ Countries having abundant capital should produce capital intensive goods.
- ✓ Countries having abundant labour should produce labour intensive goods.
- ✓ Ohlin & Heckscher suggests countries to produce goods based on factor endowment available. E.g. USA with abundant Capital should produce capital intensive Goods while India with abundant labour should produce labour intensive goods.
- ✓ Hecksher and Ohlin state that the pattern of international trade is determined by the differences in factor endowments rather than the differences in labour productivity.

The Factor Endowment theory consists of two theorems:

1) **Heckscher-Ohlin Theorem:** examines the reasons for comparative cost differences in production and states that a country has comparative advantage in the production of that commodity which uses more intensively the country's more abundant factor.

2) **Factor Price Equilization Theorem:** examines the effect of international trade on factor prices and states that free international trade equalises factor prices between countries relatively and absolutely and thus serves as a substitute for international factor mobility.

6) **The Leontief Paradox (1953)**

The Leontief Paradox postulated that there are many other factors to decide what things are to be produced other than factors endowment. They actually compared data of USA in 1950's and saw that since USA was a capital based economy hence it should have been exporting capital intensive goods, However, on the contrary data showed that USA was exporting labour intensive goods which came to known as the "Leontief Paradox".

7) **The Product Life Cycle Theory by Raymond Vernon (1966)**

- ✓ Raymond Vernon focuses on the product rather than country and its cost advantage.
- ✓ According to this model, an innovative product is often first introduced in an advanced country.
- ✓ The theory explains how trade patterns change overtime.
- ✓ He says that each product passes through different stages along with changes in knowledge, technology, information and costs.
- ➢ *Waterfall model/Trickle down approach:* A new product is first introduced to the high income country and subsequently to the middle income and low income countries.
- ➢ *Shower approach:* A new product is simultaneously introduced in all markets (high income, middle income and low income countries) because of the emergence of the global village and fast obsolescence of the product.

❖ **BALANCE OF PAYMENT ACCOUNT:** is a statistical statement that summarises a country's economic transactions with other countries of the world during a specific period of time.

BOP Account shows:

1. Transactions in goods and services, income between an economy and rest of world.

2. Changes in ownership and other changes in that country's monetary gold, Special Drawing Rights (SDRs) and claims on and liabilities to the rest of the world.

3. Unequited transfers and counterpart entries are any entries for the foregoing transactions and changes which are not mutually offsetting.
   Remittance is the money sent by Indians staying abroad to their families.
   Counterpart entries is the money sent by foreigners to their country but staying in India

Characteristics of Balance of Payment

1. **Summary** :

✓ BOP transactions are recorded as per the *double-entry system of bookkeeping*. i.e. Debit and Credit

✓ Therefore, BOP Account must always balance.

✓ Errors and Omissions of items are added to Suspense Account.

2. **Economic Transactions:** BOP involves receipts on account of exports of goods and services and capital received by residents. Also, payments made for imports of goods and services and capital transferred to non-residents/ foreigners; income on investments remitted abroad or received from abroad and increase or decrease in international reserves of the country.

3. **Country with rest of the world**: BOP contains transactions of a country with the rest of the world

4. **Flow Statement**

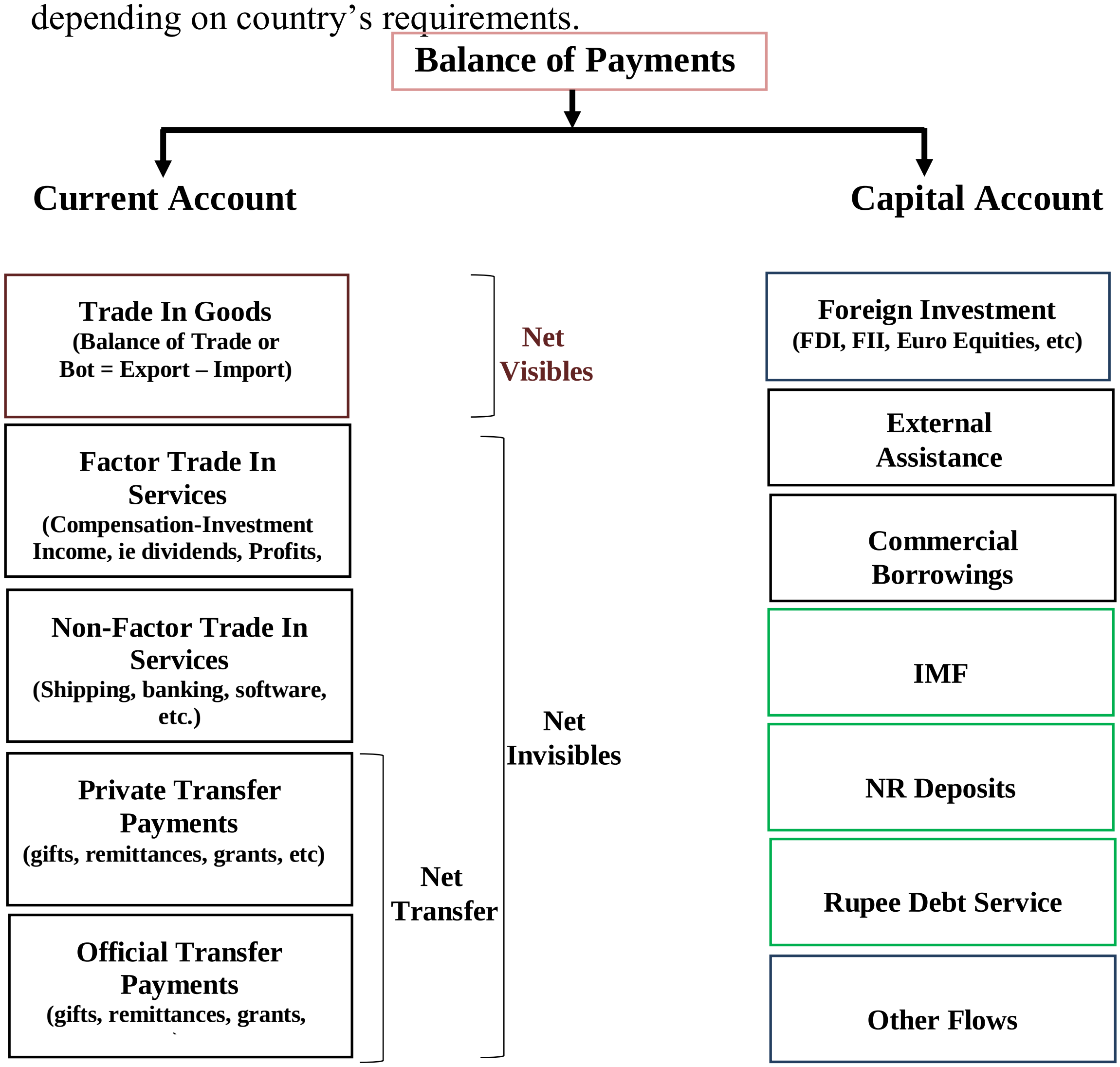
✓ BOP is a compilation of the flow of economic transactions.

✓ It is more likely a fund flow statement rather than like a balance sheet. It is not a statement of the position on a particular date.

5. **Definite time period**

✓ Transactions are cover a specific time period usually one year.

✓ However, it may be for shorter period also such as six months, three months or one month depending on country's requirements.



- **Components of Balance of Payment Account**
  1. Current Account
  2. Capital Account
  3. Unilateral Payments Account
  4. Official Reserves Account

(1) **Current Account**: includes all transactions that increase or decrease country's national income and focus on imports and exports from a country.

CURRENT ACCOUNT

Visible or Merchandise exports and imports	***Invisible or Service exports and imports.***
Merchandise exports or sale of goods abroad are credit entries because these create monetary claims on foreigners.	Invisible exports or sale of services abroad are credit entries.
Merchandise imports or purchase of goods from abroad are debit entries because they create money claims of foreigners on the home country.	Invisible imports or purchase of services from abroad are debit entries.
• Exports • Imports	• Foreign trade • Transportation • Insurance Government not included elsewhere • Investment income • Transfer payments • Miscellaneous

NOTE: Invisible export/import of services includes transportation, tourism, insurance, banking, financial services, salaries interests and dividends.

The current account balance indicates the difference between inflows and outflows of the value of the flows of goods, services, income and gifts. It is the largest component of BOP.

1. **When inflows are more than outflows**

✓ Current Account – Positive means Surplus

✓ Here, Surplus means the country has Net Foreign Investment (Lender/Investor abroad). It indicates that savings are more than domestic investment and more production than consumption. In this situation country should increase its exports.

2. **When outflows exceeds inflows**

✓ Current Account – Deficit means Negative.

✓ Here, Deficit means Net Borrowings (Net borrower from abroad) indicates domestic savings are less than domestic investment, less production than consumption and also expenditure exceeds its production. In this situation country should decrease its imports.

(2) **Capital Account**: consists of short-term and long term capital transactions. Capital outflow represents debit and capital inflow represents credit.

a) **Private Capital Account:** includes short term (maturity period of one year) and long term (maturity period of more than 1 year) capital transactions.
b) **Banking Capital Account:** includes movements in external financial assets and liabilities of commercial banks and co-operative banks which are authorised to deal in foreign exchange.
c) **Official Capital Account:** refers to RBI's holdings in foreign currency and Special Drawing Rights (SDRs) with Government.

- ✓ Inflows of capital from abroad are credit entries. Eg: Foreign long term investments in home country.
- ✓ Outflows from home country are debit entries. Eg: Long Term Investments abroad.

(**3**) **Unilateral Transfers (another term for gifts) Account**: includes private remittances, government grants, repo ratings, disaster relief, gifts, pension, etc.

- ✓ Debit means Payment made to foreign countries.
- ✓ Credit means Payment received from abroad.

(4) Official Reserves Account : include official purchases and sales of foreign currencies and other reserves for the settlement of international claims.

- ✓ Debit – Purchase of foreign currency and service assets.
- ✓ Credit - Sale of foreign currency and other reserve assets abroad.

Causes of disequilibrium in balance of payment

- ✓ BOP is said to be in equilibrium when demand and supply of foreign currency are equal.
- ✓ Disequilibrium in BOP can be deficit or surplus in BOP.
- ✓ Deficit arises when demand of foreign currency exceeds its supply.
- ✓ Surplus arises when supply of foreign currency exceeds its demand.

- **Factors affecting disequilibrium in BOP**

- ➢ BOP is said to be in equilibrium when the demand for foreign exchange is exactly equivalent to the supply of it.
- ➢ BOP is said to be in disequilibrium, when it shows either surplus or deficit.

1. Economic Factors

a) Development Disequilibrium

When a developing country like India grows it leads to large scale investment in country's infrastructure and capital goods. Imports of capital goods and consumer goods result in huge long term demand of capital. That Capital is being provided by the Developed Countries and hence large inflow of currency leads to deficit in BOP. So, presently India and China are facing development disequilibrium.

b) Cyclical Disequilibrium arises due to fluctuations in imports and exports caused by business cycles. This is temporary and goes away with a period of time. Both boom and depression create disequilibrium in BOP.

- BOOM in business activity increases aggregate demand, consumption and prices, imports of consumer goods to meet the increase in demand, imports of capital goods to expand production.
- DEPRESSION in country leads to increase in exports because production exceeds home demand.

c) **Secular Disequilibrium**: Disequilibrium in BOP due to secular trends in developed countries' economy, there is high demand and high disposable income, high cost of production due to high wage rates. Thus, country imports goods from where quality products are produced at lower costs. Therefore, huge imports create deficit in BOP even in developed countries. The disequilibrium in USA is a prime example of Secular Disequilibrium.

d) **Structural Disequilibrium:** Structural changes in the structure of the economy includes shift from agriculture to manufacturing sector and from manufacturing to service sector, this increases imports of both capital and consumer goods which causes deficit in BOP.

2) Political factors

✓ Political instability, civil wars, riots, terrorism, external war, etc. create threat for industry and investment.

✓ This leads to large capital outflows and decline in domestic production and exports.

3) Sociological factors: Changes in tastes, preferences, fashions may affect imports and exports which causes disequilibrium in BOP.

❖ International Economic Institutions

The Bretton Woods Conference proposed the setting up of:

1. International Monetary Fund (IMF) to alleviate the problems of international liquidation (to help the member countries meet their BOP deficits) and to achieve international monetary stability.
2. The International Bank for Reconstruction and Development (IBRD) to help reconstruction and development of various national economies by providing long-term capital assistance.
3. The International Trade Organization (ITO) to work towards the liberalization of international trade.

1. International Monetary Fund (IMF)

✓ In 1944, at Bretton Woods Conference, in New Hampshire (USA) two important financial institutions were created i.e., IMF and World Bank .

✓ IMF was established on 27th December, 1945.

✓ The main function of IMF is to provide short term (temporary) liquidity to its member countries on account of BOP problem i.e temporary financial assistance to overcome problems in BOP.

✓ World Bank deals with long term financing in respect of reconstruction and development.

✓ Membership of IMF is a prerequisite for membership of World Bank.

✓ IMF consists of total 189 countries.

Objectives of IMF

1. To promote international monetary cooperation among member nations.
2. To promote growth of international trade among member nations.
3. To correct problems relating to BOP.
4. To promote exchange rate stability among member nations.
5. To promote balanced expansion of world trade.
6. To bring stability of exchange rates.
7. To avoid competitive currency devaluations.
8. To assist in orderly correction of country's BOP problems.

Objectives of IMF

- ✓ To promote international monetary co-operation through proper consultation on various problems.
- ✓ To provide balanced growth of international trade and to promote higher levels of income of employment.
- ✓ To promote exchange stability.
- ✓ To provide funds temporarily to them for proper utilization of resources.
- ✓ To eliminate exchange control with a view to encourage the international trade.
- ✓ To promote export of capital in underdeveloped and poor countries.
- ✓ To minimise the imbalance in quantum and duration of external trade.
- ✓ To develop multilateral system of payments in respect of various transactions.

❖ **Types of Lending Given By IMF**

I. Regular Lending Facilities	1) *Stand-By Arrangements (SBA)* 2) *Extended Fund Facility (EFF)*
II. Special Lending Facilities	1) *Supplemental Reserve Facility (SRF)* 2) *Contingent Credit Lines (CCL)* 3) *Compensatory Financing Facility (CCF)*
III. Concessional Lending Facilities	1) *Poverty Reduction and Growth Facility (PRGF)*

- **Non-concessional loans are provided with a market-based interest rate through five mechanisms:**

1) **Stand-By Arrangements (SBA):** Under the **Standby Arrangements**, member countries are allowed to borrow over a period of one to two years to support macroeconomic stabilization programmes and repayments are made within three to five years.

2) **Extended Fund Facility (EFF):** Under the **Extended Fund Facility,** countries borrow for a period of three to four years largely for to correct BOP difficulties that stem from structural problems and take longer to correct. The repayment period is five to ten years down the line.

3) **Supplemental Reserve Facility (SRF):** Member countries can also avail themselves of the Fund's short-term financing facilities. The **SRF** provides very short-term financing on a large scale to emerging market economies experiencing sudden and disruptive loss of mart (public sale) confidence as a result of massive outflows of capital. Countries drawing under SRF are expected to repay within 1 to 1 and half years. Board may extend date but not later than 2 to 2 and half years.

4) **Contingent Credit Lines (CCL):** The **CCL is intended to be a preventive measure solely for members concerned about their potential vulnerability to contagion but not facing a crisis at the time of commitment. It** finances national economic policies aimed at averting an economic crisis precipitated by crisis elsewhere in the world. Both types of financing require repayment within one to two years and carry a surcharge.

5) **Compensatory Financing Facility (CCF)**: The **CCF** provides loans to countries experiencing shortfalls in export earnings due to unforeseen circumstances, such as natural disasters affecting crop yields which are beyond control. Repayments are made in three and quarter to five years.

- **Poverty Reduction and Growth Facility (PRGF)**

Concessional loans are granted to low-income countries at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF). The IMF's concessional financing facility to assist poor countries facing persistent BOP problems, known formerly as the Enhanced Structural Adjustment Facility.

Emergency assistance: This assistance is available through outright purchases. Members facing a balance of payments problem can immediately withdraw up to 25 per cent of its quota in gold or convertible currency. If this is insufficient, a member country may borrow up to three times its paid-in quota.

Emergency Financing Mechanism (EFM): The EFM is to be used in rare circumstances representing, or threatening, a crisis in a member's external accounts that requires an immediate response from the IMF.

Note: Two frequently used mechanisms for IMF loans are the Standby Arrangements and the Extended Fund Facility.

- **World Bank Group**

The **World Bank Group** (**WBG**) is a family of five international organizations that make leveraged loans to developing countries. It is the largest and most famous development bank in the world and is an observer at the United Nations Development Group. The bank is based in Washington, D.C. and provided around $61 billion in loans and assistance to "developing" and transition countries in the 2014 fiscal year. The bank's stated mission is to achieve the twin goals of ending extreme poverty and building shared prosperity.

World Bank's five organizations are:

1) The International Bank for Reconstruction and Development (IBRD),
2) The International Development Association (IDA),
3) The International Finance Corporation (IFC),
4) The Multilateral Investment Guarantee Agency (MIGA) and
5) The International Centre for Settlement of Investment Disputes (ICSID).

World Bank Group Agencies

The World Bank Group consists of:-

1. **The International Bank for Reconstruction and Development (IBRD)**
   IBRD was established in 1945, which provides debt financing on the basis of sovereign guarantees

2. **The International Finance Corporation (IFC),**
   IFC was established in 1956, which provides various forms of financing without sovereign guarantees, primarily to the private sector.

Mission of IFC	To contribute to the world Bank Group's overall purpose of reducing poverty and improving living standards by playing a leading role in the development of a sustainable private sector.
Basic tools of IFC	Loan and equity financing of private enterprises, mobilization of external capital alongside its own resources and provision of related advisory and technical assistance services.
Objective of IFC	To assist the economic development of less developed countries by promoting growth in the private sector of their economies and helping mobilise domestic and foreign capital for this purpose.
Role of IFC	To stimulate the flow of private capital into productive private, mixed and private/public enterprises. IFC acts as a catalyst in bringing together entrepreneurship, investment capital and production.

3. **The International Development Association (IDA)**

- ✓ IDA was established in 1960, which provides concessional financing (interest-free loans or grants), usually with sovereign guarantees.
- ✓ It provides soft loans to poor nations.
- ✓ The terms of IDA credits, which are made to government only, are ten year grace periods, fifty year maturities and no interest.

In approving an IDA credit, three criteria are observed:

a) *Poverty test:* IDA's assistance is limited to poorest countries.
b) *Performance test:* Overall satisfactory economic policies and pass success in project execution.
c) *Project test:* IDA advances soft loans, not finance soft projects. The test essentially requires that the proposed projects yield financial and economic returns which are adequate to justify the use of scarce capital.

4. **The International Centre for Settlement of Investment Disputes (ICSID),** established in 1965, which works with governments to reduce investment risk;

5. **The Multilateral Investment Guarantee Agency (MIGA),** established in 1988, which provides insurance against certain types of risk, including political risk, primarily to the private sector.

Note: The term "World Bank" generally refers to just the IBRD and IDA, whereas the term World Bank Group or WBG is used to refer to all the five institutions collectively.

LEGAL ASPECTS OF BUSINESS

THE INDIAN CONTRACT ACT, 1872

- **Agreement:** "Every promise and every set of promises, forming the consideration for each other, is an agreement". ***Thus, Offer + Acceptance = Agreement.***

- **Contract:** "An agreement enforceable by law is a contract".
Thus, An Agreement + Enforceability at law = Contract

- **Essential elements of a valid contract**

1. **Offer and Acceptance:** To constitute a contract there must be an offer by one party and the same to be accepted by another party to whom the offer is made. But both offer and acceptance must be valid.

2. **Intention to create legal relationship:** Both the parties must have an intention of entering into a legal relationship between themselves.

3. **Consent and free consent:** When both the parties agree on the same thing in the same sense they are said to consent. Consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake.

4. **Lawful Object:** The object of the contract must be lawful. Object of a contract refers to the purpose of a contract.

5. **Lawful Consideration:** Consideration means "something in return". An agreement to be enforceable at law must be supported by consideration. The consideration must be real and lawful.

6. **Capacity of parties to contract:** Every person is competent to contract,
   a) who is of the age of majority according to law to which he is subject,
   b) who is of sound mind,
   c) who is not disqualified from contracting by any law to which he is subject.

7. **Agreement not to be declared void:** Void agreements are not enforceable by law because it does not give rise to any rights and obligations and are against to the public policy.

8. **Clarity of terms:** The terms of the agreement must be clear. If the terms and conditions of the agreement between the parties are not clear, the agreement is void i.e., not enforceable by law.

Agreement	Contract
Every promise and every set of promises forming consideration for each other is an agreement.	An agreement enforceable by law is a contract.
Offer + Acceptance = Agreement	Agreement + Enforceability at law= Contract
An agreement may or may not create legal obligations.	A contract creates legal obligation.
The scope of an agreement is wider as it covers variety of transactions.	The scope of a contract is narrower as it is limited to only those agreements, which are enforceable by law.
Agreement constitutes only offer and acceptance.	Agreement and ten essential elements make a contract. The ten essential elements are: offer and acceptance, lawful consideration, lawful object, capacity of parties to contract, consent and free consent etc.
Agreement is not final and binding on the parties.	It is final, concluding and binding on the parties.
Every agreement is not a contract.	Every contract is an agreement.
A, offers to treat B at Orchid Hotel.	A, offers to sell his parker pen to B at Rs. 2000/, which is accepted by B.

Classification of contracts

Legal Effects	Performance	Formation
1. Valid Contract	1. Unilateral Contract	1. Express Contract
2. Void Contract	2. Bilateral contract	2. Implied contract
3. Voidable contract	3. Executed contract	3. Quasi contract
4. Unenforceable contract	4. Executory contract	
5. Illegal contract		

(1) On the Basis of creation	(2) On the Basis of Validity	(3) On the Basis of execution	(4) On the Basis of Liability
a. Express contract	a. Valid contract	a. Executed contract	a. Bilateral contract
b. Implied contract	b. Void contract	b. Executed contract	b. Unilateral contract
c. Tacit contract	c. Voidable contrac	c. Partly executed and party executory	
d. Quasi contract	d. Unenforceable contract		
e. E contract	e. Illegal contract		

- **<u>Types / classification / kinds of Contract</u>**

1. **Express Contract:** An express contract is one, under which, (a) the terms of the contract are in writing, or, (b) the terms of the contract are agreed upon by words at the time of its formation.
2. **Implied contract:** An implied contract is one, in which, the terms of the contract are inferred (understood) from the act or conduct of both the parties.

3. **Contingent contract:** A contract to do or not to do something, if some event, collateral to such contract, does or does not happen is called as contingent contract.

4. **Executed Contract:** An executed contract is one, in which,

i. Both the parties to the contract have already performed their obligations, or

ii. Only one party to the contract has already performed his part of the obligation, and the other party is still under an obligation to perform his part of the promise.

5. **Executory Contract:** An executory contract is one, under which, (i) neither party has performed his part of the obligation i.e., both the parties to the contract have yet to perform their respective promises, or, (ii) there remains something to be done on the part of both the sides.

6. **Valid contract:** An agreement enforceable by law is contract. A contract that satisfies all the conditions laid down by law is a valid contract.

7. **Voidable contract:** An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others.

8. **Unenforceable contracts:** It is a valid contract, but unenforceable in the court not on merits but on technicalities of law. For example: lack of signature, lack of registration.

- **Negotiable instrument:** "A negotiable instrument means a promissory note, bill of exchange or cheque payable by order or to bearer."

Essentials of negotiable instruments

1. **Writing:** All negotiable instruments must be in writing and signed in accordance with the rules of the instrument.

2. **Payable by money:** All negotiable instruments are always payable in terms of money.

3. **Unconditional promise or order:** If the instrument is promissory note, it must contain an unconditional promise to pay. If the instrument is a bill of exchange or cheque, it must be an unconditional order to pay money.

4. **Specified amount:** The money stated in the negotiable instrument must be specific or certain.

5. **Presumptions**: Unless contrary is proved, there are presumptions in every negotiable instrument with regard to consideration, date, signature holder in due course etc.

6. **Freely transferable:** A negotiable instrument is transferable from one person to another by delivery if the instrument is payable to bearer, and by endorsement and delivery if it is payable to order.

7. **Property:** The person in possession of the instrument is having the property rights over it and is entitled to the amount.

8. **Essentials of the contract:** The negotiable instruments are enforceable by law therefore all the essentials of a valid contract namely capacity of parties, consideration, consent and free consent, lawful object etc. must be present.

- **Types of Negotiable Instruments**

1. **Bearer instrument:** A negotiable instrument which is payable to the person in the possession of the instrument. Example: Pay ‘A’ or bearer.

2. **Order instrument:** A negotiable instrument, the payment of which can be taken by a particular person to whom it is made payable or if it is made payable to the order of that particular person. Example: Pay ‘A’ or order.

3. **Inland instrument:** Inland instrument are used for inland trade. The requirements of the inland instrument are: where the drawer and drawee are in India, or where the drawer and payee are in India.

4. **Foreign instrument:** Foreign instrument is generally used for foreign trade. The requirements of foreign instrument are: where the drawer is in India, the drawee is in India while the payee may or may not be in India, or the drawer is in India while both the drawee and payee are outside India.

5. **Instrument payable on demand:** Here the instrument is payable immediately. No specific period for making the payment is mentioned. The terms 'at sight' and 'on presentment' also means 'on demand'. Example: 'A', promises to pay 'B', Rs. 1,000/- on demand.

6. **Time instrument:** Time instrument is one where the instrument is payable some time in future. Instruments payable 'after date', 'after sight' or 'at a certain period after the happening of an event which is certain to happen' are time instruments.

- **Promissory note**

a) A promissory note is an instrument in writing
b) containing an unconditional undertaking
c) signed by the maker
d) to pay a certain sum of money only to, or
e) to the order of a certain person or
f) to the bearer of the instrument".

Essentials of the promissory note:

1. **Writing:** A promissory note must be in writing.

2. **Express promise to pay:** The promissory note must contain an express promise to pay. A mere implied promise to pay is not sufficient. The wordings in the promissory note must convey a promise to pay.

3. **Unconditional promise:** The promise to pay must be unconditional. The promise to pay should not depend upon a condition which may or may not happen. However, a promissory note may be conditional on an event which is bound to happen. For example: 'A' promises to pay 'B' Rs. 1000/- on 01/01/2016 is a valid promise.

4. **Promise to pay in terms of money only:** The instrument must be payable in terms of money only. If the instrument contains a promise to pay something other than money or something in addition to money, it will not be a valid promissory note. For example: I promise to pay 'A', Rs. 1000/- and 2 bags of rice-is not a valid promissory note.

5. **Certain sum:** The amount payable must be certain and specific.

6. **Parties must be certain:** The parties to the instrument must be certain. The person making the payment and the person receiving the payment must be definite.

7. **Must be signed:** The instrument is complete only when it is signed by the maker. An instrument written by the maker and bears his name is invalid if his signature is absent.

8. **Must bear the stamp:** A promissory note must be properly stamped**.** An unstamped promissory note is not enforceable by law.

9. **Other formalities:** Formalities such as date, place, consideration etc., are usually found in a promissory note. These are only formalities as an instrument will not become invalid if any of them is not complied with.

10. **Intention and delivery:** An instrument to be a promissory note must be such as to show the intention to make a promissory note and must be delivered to the payee.

11. **Essentials of a contract:** The promissory note is enforceable by law therefore all the essentials of a valid contract namely capacity of parties, consideration, consent and free consent, lawful object etc., must be present.

Promissory Note Payable on Demand

Rs. ....

Place,
date.

On demand I promise to pay Mr._______ or order the sum of Rs. ______ with interest @ __ % p.a.

Sd/-
Name
(address)

- <u>**Bill of Exchange**</u>

a) An instrument in writing containing an unconditional order,
b) signed by the maker,
c) directing a certain person to pay
d) certain sum of money only to or
e) to the order of a certain person or
f) to the bearer of the instrument.

<u>**Essentials of the bill of exchange:**</u>

1. **Number of the parties:** A bill of exchange has three parties i.e.,
   (a) Drawer - the one, who draws the bill of exchange
   (b) Drawee - the one, who has to make the payment
   (c) payee - the one, who has to receive the payment. Sometimes the drawer and the payee can be one and the same person. The parties must be certain.

2. **Writing:** The bill of exchange is a negotiable instrument, it must be in writing. Oral bill of exchange is not valid.

3. **Express order to pay:** It is one of the essential elements of the bill of exchange that it must contain express order to pay by the drawer to the drawee. It must not contain request to pay. The order must be in the nature of command by drawer to drawee to make the payment to the payee.

4. **Order must be unconditional:** The bill of exchange must contain an order to pay but the order must be unconditional i.e., it must be without any conditions.

5. **Order to pay money only:** The bill of exchange must be for the payment of money and not of anything else.

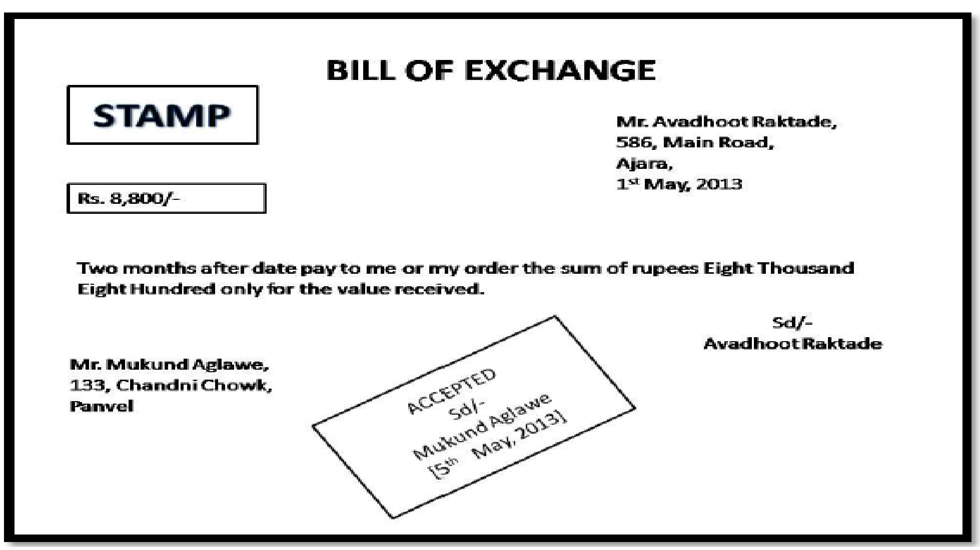
6. **The sum payable must be certain:** The amount payable on the bill of exchange must be certain and specific.

7. **Must be signed:** The instrument is complete only when it is signed by the maker or the drawer. The bill of exchange must be signed by the drawer. If the drawer writes his name on the instrument it will be considered as invalid.

8. **Other formalities:** Formalities such as date, place, consideration etc., are usually found in a bill of exchange without these formalities the bill of exchange will not become valid, if any of them is not complied with.

9. **Intention and delivery:** An instrument to be a bill of exchange must be such as to show the intention to draw a bill of exchange and must be delivered to the payee.

10. **Essentials of a contract:** The bill of exchange is enforceable by law therefore all the essentials of a valid contract namely capacity of parties, consideration, consent and free consent, lawful object etc., must be present.



Parties to the Bill of Exchange

1. **Drawer:** The maker of a bill of exchange is called drawer. The drawer is the person who draws the bill.

2. **Drawee:** The person on whom the bill is drawn is known as the drawee. The maker of a bill of exchange or cheque is called the drawer; the person thereby directed to pay is called the drawee.

3. **Payee:** Payee is a person to whom the bill is made payable. The drawer or any other person can be the payee. The payee is the real beneficiary under the instrument.

4. **Endorser and Endorsee:** When a holder endorses or transfers the instrument to anybody else, the holder becomes the endorser. The person to whom the bill is endorsed, he is known as an endorsee.

5. **Holder:** A person who is legally entitled to the possession of the bill of exchange in his own name and entitled to receive the amount of the bill is called a holder. He is either the original payee or the endorsee. If the bill is payable to the bearer, the bearer is the holder.

- **Cheque**

a) A bill of exchange drawn on a specified banker and
b) not expressed to payable
c) otherwise than on demand and
d) it includes the electronic image of a truncated cheque and
e) a cheque in the electronic form.

Essentials of cheque:

1. **Writing:** The cheque being a negotiable instrument it must be in writing.

2. **Unconditional:** The order to pay must be unconditional.

3. **Signature of the drawer:** It must be signed by the maker.

4. **Certain sum of money:** The amount stated in the cheque for payment must be certain, specific and definite.

5. **Payee must be certain:** It must be payable to specified person. The name of the payee must be written specifically and clearly.

6. **Only money:** The cheque is issued only for the payment of money only.

7. **Payable on demand:** Cheque is always payable on demand. Unless and until the payee demands the payment from the drawee bank the cheque will not be honoured.

8. **No stamp:** A cheque does not require stamp as it requires in case of a promissory note.

9. **Payable to bearer:** A cheque can be made payable to bearer.

10. **Drawn on a specified banker:** Cheque is a bill of exchange but it always drawn on bank.Drawee in case of a cheque is always a specified banker.

11. **No acceptance:** No acceptance is necessary by the drawee before the demand for payment.

12. **Specimen signature:** The drawer should put his signature on the cheque according to the specimen signature given to its bank at the time of the opening of the account. If there is difference in the signature on the cheque and specimen signature on the cheque, cheque will be dishonoured.

13. **Other formalities:** Formalities such as date, place, consideration etc., are usually found in a cheque without these formalities the cheque will not become valid, if any of them is not complied with.

14. **Intention and delivery:** An instrument to be a cheque must be such as to show the intention to draw a cheque and must be delivered to the payee.

15. **Essentials of the contract:** The cheque is enforceable by law therefore all the essentials of a valid contract namely capacity of parties, consideration, consent and free consent, lawful object etc. must be present.

- **Types of cheques**

a. **Open or Bearer cheque:** Open cheques are those which can be directly presented to the drawee-bank for payment across the counter. They need not to be presented through a bank. There is certain degree of risk attached to such cheques. If the cheque is bearer the process is simple. Crossing has been introduced to avoid, as far as possible, the losses incurred by open cheque getting into wrong hands.

b. **Order cheque:** If the amount of money mentioned in the cheque is to be given to the specified person or to the order of that person after the presentation of the cheque to the bank on which the cheque is drawn, it is known as order cheque.

c. **Crossed cheque:** A crossing is a direction to the paying bank to pay the money generally to a bank or to a particular bank, and when this has been done the whole purpose of the crossing has been served. It is the safest mode of issuing a cheque. The object of crossing is to secure payment to a bank, in order to facilitate tracing of the person for whose use the money was received. Crossing is done by drawing two parallel lines on the face of a cheque can be crossed. Such cheques are presented through payee's banker and the amount is credited to his account.

- **Reasons for dishonour of cheque by bank**

1. When the customer has died and the bank has notice of his death.
2. When the customer has become insolvent or an order of adjudication has been passed against him.
3. When a customer becomes a lunatic and the banker has got notice of his insanity.
4. Where the drawer informs the bank that the cheque is lost.
5. Where there are material alterations or the signatures of the drawer or endorsees are irregular.
6. When the banker suspects that the title of the person presenting the cheque is defective.
7. When the banker has knowledge that the customer intends to use the funds in breach of trust.
8. Post-dated cheque presented before the date the mentioned on the cheque. Post-dated cheque is payable on the date mentioned on it but not before.
9. Cheque presented beyond the period of three months from the date of issue of the cheque.
10. If the banker is not holding sufficient funds of the drawer unless the banker has agreed to honour the cheque without sufficient funds.
11. Where the cheque is drawn on another branch office of the same bank where the customer does not have an account

Penalty for dishonour of cheques:
The person who fails to make the payment he shall deemed to have committed an offence which shall be punishable with imprisonment for a term which may extend to two 2 years or with fine which may extend to twice the amount of the cheque or both.

BANKING & FINANCIAL INSTITUTIONS

- **Central Bank**
- ✓ Central Bank is an apex institution in the financial and banking structure of the country.
- ✓ India's central bank is Reserve Bank of India (RBI) which is the Financial Advisor and Banker to Government.
- ✓ The central bank plays an important role in organizing, running, supervising, regulating and developing the banking and financial structure of economy.
- ✓ In 1926, Royal Commission of Indian Currency and Finance which is also known as Hilton – Young Commission recommended the creation of Central Bank (RBI)

Aims To Form RBI

1. To separate control of currency and credit from government.
2. To augment banking facilities throughout the country.

- **RBI**

✓ The RBI Act, 1934 established RBI.
✓ Started its operations on 1st April, 1935 as a private owned entity.
✓ Central Office was in Kolkata then shifted to Mumbai in 1937 and has worked as the Headquarters.
✓ RBI was nationalized in 1949.
✓ It has a Governor and four Deputy Governors.
✓ RBI has four zonal offices (MKCD) – Mumbai, Kolkata, Chennai, Delhi.
✓ There are 20 offices in State Capitals and 11 sub-offices.
✓ Currently Urjit Patel is the Governor of RBI appointed by the Central Government.
✓ RBI is the supreme monetary and banking authority in India and controls the Banking system.
✓ It keeps reserves of all commercial banks.
✓ India became a member of the International Monetary Fund (IMF) in 1946, RBI has the responsibility of maintaining fixed exchange rates with all other member countries of the IMF.

- **Functions of RBI**

1. Bank of Issue

✓ Sole authority to issue currency, which is a legal tender money .
✓ RBI enjoys monopoly of issuing currency notes and coins.
✓ But one rupee coin/note is issued by Finance Ministry and has the Finance Secretary signature on it.
✓ RBI issues and exchanges currency as well as destroys currency and coins not fit for circulation to ensure that the public has an adequate quantity of supplies of currency notes and in good quality.

2. Banker To Banks and Government

✓ Acts as custodian of cash reserves of commercial & other banks.
✓ RBI provides short term credit to commercial banks & gives guidance & direction and regulates their activities.
✓ It performs merchant banking function for the central and the state governments; also acts as their banker.
✓ It maintains the banking accounts of all scheduled banks and acts as the banker of last resort.
✓ RBI is an agent of Government of India in the IMF.

RBI and Government

1. Receives deposits of cash, cheques, drafts etc. from government.
2. Provides cash to government for paying salaries and wages and cash disbursements.

3. Make payments on behalf of government.
4. Gives short term loans to government.
5. Buys and sells foreign currencies on behalf of government.

3. **Regulation of credit**

- ✓ RBI controls the creation of credit by commercial banks.
- ✓ Banks can adopt several measures to control credit creation which are changing the bank rate, open market operations, change in the reserve requirement of the commercial banks, etc
- ✓ RBI also controls the loan policy, interest policy and investment policy of the commercial banks.

4. **Manager of Foreign Exchange** :RBI manages forex under the FEMA- Foreign Exchange Management Act, 1999. In order to A) facilitate external trade and payment B) promote the development of foreign exchange market in India.

5. **Developmental role:** RBI performs a wide range of promotional functions to support national objectives. Under this it setup institutions like NABARD, IDBI, SIDBI, NHB, etc.

6. **Regulator and supervisor of the payment systems**

a) Authorises setting up of payment systems;
b) Lays down standards for working of the payment system;
c) Lays down policies for encouraging the movement from paper-based payment systems to electronic modes of payments.
d) Setting up of the regulatory framework of newer payment methods.
e) Enhancement of customer convenience in payment systems.
f) Improving security and efficiency in modes of payment.

7. **Lender of Last Resort** (LOLR)

RBI provides directly or indirectly all reasonable financial assistance to commercial banks to help them to come out of financial crisis. The banks approach RBI when they are unable to get help from everywhere else. It recommends which bank is to be liquidated. Credit and Bank money are important and dominant form of money presently.

8. **Controller of Credit**

RBI adopts quantitative & qualitative methods of credit control to ensure smooth functioning of the economy.

- ➢ Quantitative Methods: aim at controlling the cost and quantity of credit by adopting bank rate policy, open market operations and variations in reserve ratios of commercial banks. Eg. SLR, CRR, Repo rate, Bank rate, etc.
- ➢ Qualitative Methods: influence the use and direction of credit through policy directions, moral suasion, summits, etc.

Powers of RBI

1. It holds cash reserves of all the scheduled banks.
2. It controls the credit operations of banks through quantitative and qualitative controls.

3. It controls the banking system through the system of licensing, inspection and calling for information.
4. It acts as a lender of the last resort by providing rediscount facilities to scheduled banks.

Central Bank	Commercial Bank
➢ Not a profit making institution. Acts in public interest to control and regulate banking and financial system of country	➢ Aims at making profit.
➢ Do not perform ordinary function i.e. does not accept deposits from general public of country.	➢ Performs ordinary functions. Accepts deposits.
➢ Owned by Government and managed by Government officials RBI is organ of Govt.	➢ Owned by both private individuals as shareholders & by government.
➢ Sole Monopoly of note issue	➢ Cannot issue notes.
➢ Controls and regulates the entire banking system of a country.	➢ Operates under the direct control and supervision of the central bank.
➢ Does not deal directly with the public. It issues guidelines to commercial banks for the economic development of a country.	➢ Deals directly with the public. It serves the financial requirements of the general public by providing short and medium term loans and depositing and securing money that can be drawn on demand.
➢ Issues currency and controls the supply of money in the market.	➢ Does not issue currency, but adds to the money supply by creating demand deposits.
➢ Acts as a state owned institution	➢ Acts as a state or private owned institution
➢ Acts as a custodian of foreign exchange of the country	➢ Performs foreign exchange business only on the approval of the central bank.
➢ Controls credit creation in the economy, thus acts as a clearing house of other banks	➢ Acts as a clearing house only as an agent of the central bank
➢ Works for the public welfare and economic development of a country. A central bank is governed by the government of a country.	➢ Operates for profit motive. The majority of stake is held by the government as well as the private sector.

Functions of Commercial banks

I. Primary functions

(1) Acceptance of deposits: Banks mobilize deposits from the public. Banks are also called as custodians of public money.

Types of deposits

a) Fixed deposit accounts: The term fixed here denotes tenure. It has higher rate of interest than other types of deposits but money is deposited for a fixed period of time. Deposits can be withdrawn before the period is over but interest payable to the depositor goes down in such case.

b) Demand deposits: are of two types--- Saving account and current account

- Savings account: Interest rates are better than current deposits but lesser than fixed deposits. It is to attract lower income households to save money. The rate of interest on saving bank deposits is decided and fixed by concerned banks themselves.

- Current account
- ✓ It is an account with minimum amount of restrictions.
- ✓ Overdraft facility is also provided to current account holder based on the credit worthiness of customer.
- ✓ No limitations on amount of deposit and number of withdrawals.
- ✓ Generally, interest is not paid on current deposits rather a fee is charged from them.

***(1)* Granting loans and advances**

- ✓ The banks accept deposit from public for safe keeping and pay interest to them. They lend this money to earn interest on it.
- ✓ The difference between the rate of interest paid on deposits and charged on loans is called **spread.**
- ✓ The rate of interest charged on loans and advances varies according to the purpose and period of loan and the mode of repayment.
- ✓ A **loan** is granted for a specific time period. It can be for short term or long term. It may be given in lumpsum or instalments. It is granted against the security of certain assets and is normally repaid in instalments and also in lumpsum.
- ✓ An **advance** is a credit facility provided by the bank to its customers. It is granted for a short period of time to meet day-to-day requirements of business.
- ✓ The banks also lend money to people on the basis of their perceived personal worth. Such loans are called **clean loans.**
- ✓ Banks provide loans to industries, individuals, and business, agriculture, for export and import trade.

***(2)* Cash credit account:** is an arrangement in which the bank allows the borrower to withdraw an amount up to a specified limit as and when he requires.

***(3)* Overdraft:** means the act of overdrawing from a bank account. The account holder withdraws more money from a bank account than deposited in it.

(4) **Bill discounting:** The bank takes the bill drawn by the borrower on his customer and pays him immediately deducting some amount as discount/commission. The bank them presents he bill to the borrower's customer on the due date of the bill, and collects the total amount.

(5) **Term loan:** is made when the repayment is sought to be made in fixed, predetermined instalments. This type of loan is normally given to the borrowers for acquiring long term assets (more than one year).

II. **<u>Secondary functions</u>**

(1) **Agency functions** (Refer from table)

(2) **Bill of exchange and Promissory notes**

✓ <u>Bill of exchange</u> is a written order by the drawer to the drawee to pay money to the payee. Cheque is the most common type of bill of exchange, which is drawn on a banker and payable on demand.

✓ <u>Promissory note</u> is a contract detailing the terms of a promise by one party (the maker) to pay a sum of money to the other (the payee). It includes the principal amount, the interest rate if any, and the maturity date.

(3) **Execution of standing orders:** A standing order is an instruction on account holder gives to his bank to pay a set amount at regular intervals to another account. This instruction is sometimes known as a **banker's order**. It is usually suitable for paying fixed regular bills rather than variable bills such as credit card, gas or electricity.

III. **<u>General utility functions</u>**

(1) **Safe custody:** Banks provide security to the money and valuables of the general public by giving locker facilities.

(2) **Remittance of funds:** is the act of transfer of money, both domestic and foreign, from one place to another. Banks issue demand drafts, banker's cheques, money orders, etc and telegraphic or tele cash orders and electronic mode for quick transfer.

(3) **Demand draft:** DD is a negotiable instrument used for transfer of money.

(4) **Issuing letter of credit:** Letter of Credit is usually a negotiable instrument issued by importer's bank to its branch/Agent abroad authorizing payment of a specific sum to a person named in letter of credit (Usually exporter from abroad). The basic types of letter of credit are as follows:

(i) **<u>Commercial letter of credit:</u>** is the primary payment mechanism. It is a contractual agreement between a bank known as the issuing bank, on behalf of one of its customers, and another bank, known as the advising or confirming bank.

(ii) <u>Standby letter of credit:</u> is a secondary payment mechanism. It is a guarantee of payment issued by a bank on behalf of a client that is used as "payment of last resort" should the client fail to fulfill a contractual commitment with a third party. It is an arrangement where a bank guarantees payment to a 'beneficiary' if something fails to happen.

(iii) <u>Revocable letter of credit:</u> can be changed at any time by either the buyer or the issuing bank with no notification to the beneficiary, as it does not provide any protection to the beneficiary and are not used frequently.

(iv) <u>Irrevocable letter of credit:</u> only allows change or cancellation of the letter of credit by the issuing bank after application by the buyer and approval by the beneficiary.

<u>(*)Utility Services</u>

- Locker facility: to keep your personal belongings.
- Draft facility: Demand Draft can be made at the branches
- Letter of credit: It's an important document used in International trade
- Agency services: Payment of cheques, Electricity, Telephone bills, sale and purchase of securities are part of the Agency Services provided by the bank.

<u>Summary of functions of commercial banks</u>

Accepting Deposits	**Making loans and Advances**	**Agency functions**	**Utility functions**
Current or Demand Deposit Account	Advancing loans	Collection of cheques, bills, interest,etc	Safe custody of valuables (Locker facility)
Saving Bank Account	Cash credit	Issuing standing orders for payments	Underwriting of capital issues and loans
Fixed or Time Deposit	Overdraft	Purchase and sale of securities , foreign exchange	Accepting Bills of Exchange, Traveller's cheque and letter of credit
Home Safe Saving Account, Recurring Deposit Account	Purchasing and Discounting of Bill of Exchange, Investment in Government Securities	Transfer of funds, Acting as a Treasurer, Trustee, Executor of Attorney, Providing letter of reference	Providing Trade information and Statistics dealing in foreign exchange, Advice on financial matters, Providing credit information about customers

❖ **<u>Money market:</u>** is a mechanism through which short-term funds are loaned or borrowed. It provides liquidity of cash to the lenders. What a bank balance is to the individual, the money market is to the country's credit system.

Instruments of Money Market

1) **Call money:** When money is borrowed or lent for a day, it is known as call (overnight) money.

2) **Notice money:** When money is borrowed or lent for more than a day or up to 14 days, it is called notice money.

The Narasimham Committee (1198) recommended that call/notice money market in India should be made purely an inter-bank market.

3) **Inter-bank term money:** Inter-bank market for deposits of maturity beyond 14 days is referred to as the term money market. The Discount and Finance House of India (DFHI) is putting in all the efforts to activate this market.

4) **Treasury bills:** are money market instruments to finance the short-term requirements of the Government of India. These are based on the maturity period and utility of the issuance such as ad-hoc, 3 months and 12 months treasury bills. In India, at present, there are the 91days and 364 days treasury bills.

5) **Certificates of Deposit (CD):** is a negotiable money market instrument, issued in dematerialized form or a Usance Promissory Note for funds deposited at a bank or other eligible financial institution for a specified time period.

The salient features of CD are:

(1) CDs can be issued to individuals, corporations, companies, trusts, funds, associates, etc.
(2) NRIs can subscribe to CDs as non-repatriable basis.
(3) CDs attract stamp duty as applicable to negotiable instruments.
(4) Banks have to maintain SLR and CRR on the issue price of CDs. No ceiling on the amount to be issued.
(5) The minimum issue size of CDs is Rs.5 lakh and multiple thereof.
(6) CDs are transferable by endorsement and delivery.
(7) The minimum lock-in-period for CDs is 15 days.

6) **Commercial papers (CP):** refer to short-term unsecured promissory notes normally issued by corporate companies with a high credit rating. It was first introduced in 1990. Maturity of commercial paper is minimum of seven days and a maximum of up to one year from the date of issue. It is sold at a discount but redeemed at its par value.

❖ **Industrial Securities Market**

1) **Primary market:** also called as the market for public issues. It refers to the raising of new capital (equity or debt, i.e. equity shares, preference shares, debentures or rights issues) by corporate.

✓ Rights issue is when equity shares are exclusively offered to the existing shareholders

- ✓ Initial Public Offering (IPO) is when a company after incorporation approaches the public for the first time for subscription of its public issue.

The transactions relating to the primary market are not carried out through stock exchange.

Underwriters are financial institutions which undertake to secure a committed quantum of equity/debt subscribed by the public, failing which they accept these shares/bonds as their own investment.

2) Secondary stock market: deals with the sale/purchase of already issued equity/debts by the corporate and others. The sale/purchase of these securities are carried out at the specific stock exchange(s), where the companies get their public issues listed for trading.

❖ **Stock Exchanges**: are organized marketplaces, either corporations or mutual organizations, where members of the organization gather to trade company stocks and other securities.

✓ **BSE-Bombay Stock Exchange**

- BSE was established in 1875 located in Mumbai and it is the oldest stock exchange in Asia
- BSE's screen based trading is known as BOLT- Bombay online trading, which was introduced in 1995
- Benchmark index is Sensex

✓ **NSE-National Stock Exchange**

- On the recommendations of Pherwani Committee, NSE was incorporated in November 1992 as a tax paying company. In 1992, it was recognized as stock exchange under the Securities Contract Act, 1956.
- It introduces a nationwide Very Small Aperture Terminals (VSAT) – driven screen based trading system.
- NSE's screen based trading is known as NEAT- National exchange for automated trading.
- Benchmark index is Nifty

❖ **Non-Performing Assets**

- It is a loan or advance for which the principal/interest payment remained overdue over a period of 90 days.
- An asset is tagged as NPA when it ceases to generate income for the lender.
- It refers to loans that are in jeopardy of default
- Loan is considered to be NPA, if the borrower fails to make interest, principal amount payments for 90 days.

NPA is a loan/advance where:-

1. Interest/Installment of principal remain overdue for period of more than 91 days in respect of term loan

2. Account remains out of order for period of more than 90 days in case of overdraft/cash credit
3. Bills remain overdue for 90 days or more in case of bills purchased/discounted.
4. Interest/Installment remains overdue for two harvest seasons but for a period not exceeding two half years in case of advances granted for agricultural purpose.
5. Non submission of stock statements for 3 continuous quarters in case of cash credit facility
6. In case of no active transactions in the account for more than 91 days.

- **Insurance:** *Insurance is a contract between two parties (namely insurer and insured or assured) whereby one party (insurer) undertakes in exchange for a fixed amount of money (premium) to pay the other party (Insured), a fixed amount of money on the happening of certain event (death or attaining a certain age in case of life) or to pay the amount of actual loss when it takes place through the risk insured (in case of property)*

Insurance is a contract between the insurer and the insured. The insurer undertakes to compensate the insured for the loss arising from the risk insured against. In consideration, the insured agrees to pay a premium regularly.

The person whose risk is insured is called Insured/Assured.

The person who agrees to compensate the loss arising from the risk is called the Insurer/Assurer/Underwriter.

Terminology used in definition of Insurance

✓ *Insurer or insurance company*: The agency involved in Insurance business is known as insurer

✓ *Insured/ Assured*: The person who gets his property/life insured is known as insured

✓ *Policy:* The agreement or contract which is put in writing is known as a Policy

✓ *Premium:* The consideration in return of which the insurer undertakes to make goods the loss or give a certain amount in case of life insurance is known as premium

- **Principles of Risk Insurance Management**

1. **Principles of Risk Identification:** Without proper identification of risk, a firm's operations have no meaning and direction.
2. **Principles of Risk Analysis:** Analysis of a risk by selecting necessary not only to know the level of severity of risk but also to determine the accuracy and relevance exposure at each stage.
3. **Principles of Risk Assessment:** This is essential to keep reducing the cost of risk within control.
4. **Principles of Taking Corrective Decision:** In this, decision making is a process involving information, choice of alternative action, implementation and evaluation that is directed to the achievement of certain stated goals.
5. **Principles of Evaluation:** A proper evaluation is necessary to determine the best alternative.

6. **Principles of Alternative course of Action:** The final choice from among the several alternatives will be based on how efficiently the risk manager's chosen alternative will produce results which come up to the desired level.
7. **Principles of Risk Control:** Effective control provides the yardstick to measure the effectiveness of performance at various levels of handling risk.
8. **Principles of Risk Retention:** Manager can look to this principle as to how the effects are to be financed.
9. **Principles of Risk Transfer:** This helps to analyse the transfer of financial effect of risk to another party.

- **Re-insurance**

✓ Reinsurance is the practice wherein an insurance company (the insurer) transfers a portion of its risks to another (the reinsurer).

✓ When insurance companies need to buy insurance for themselves, it's called reinsurance. It is practiced by the insurer to spread the loss.

✓ Reinsurance is the mechanism termed as insurance of 'insurance' means that an insurer who has assumed a large risk may arrange with another insurer to insure a portion of the insured risk.

✓ Reinsurance is also known as insurance for insurers or stop-loss insurance. Reinsurance is the practice whereby insurers transfer portions of their risk portfolios to other parties by some form of agreement to reduce the likelihood of paying a large obligation resulting from an insurance claim.

✓ The party that diversifies its insurance portfolio is known as the ceding party.

✓ The party that accepts a portion of the potential obligation in exchange for a share of the insurance premium is known as the reinsurer.

Elements of reinsurance

Reinsurance is a form of insurance.

There are only two parties to the reinsurance contract- the Reinsurer and the Reinsured- both of whom are insurers i.e entities empowered to insure.

Reinsurance contract is an indemnity.

Ceding Insurer: The insurer who obtains a guarantee (or places reinsurance)

Re-insurer: The insurer who grants a guarantee (or accepts reinsurance) from the direct insurer.

✓ **Cession** is the amount reinsured with the reinsurance i.e., ceded to the reinsurer.

✓ There are two contracts on the subject matter. The first contract is between the original insurer or direct insurer and the owner of the subject matter or the original insured.

✓ The other contract (reinsurance contract) is between the original insurer and the reinsurer. In the case of loss on the subject matter, the original insurer collects the insured sum from the reinsurer and then settles the loss value in full to the original insured.

✓ Mr. A, a factory owner, approached an insurance company 'XYZ' for an insurance of an amount of Rs. 40 crores. Company 'XYZ' has two options before it. It can reject the risk or accept the entire risk and share a part of the risk with other insurer.

✓ In case, the company 'XYZ' decides to assume the risk, by retaining Rs. 20 crores worth of insurance with it and seeking assistance of other insurer for the excess of his own limit. i.e., for the balance of Rs. 20 crores. The excess for which the company 'XYZ' is approaching the other insurer is called "Reinsurance".

- **Characteristics of Reinsurance**

1. Reinsurance is a contract between the two insurance companies.

2. The original insurer agrees to transfer part of his risk to other insurance company on the same terms and conditions.

3. The fundamental principles of insurance such as insurable interest, utmost good faith, indemnity, subrogation and proximate cause also apply to reinsurance.
4. In the event of fire, the insured is entitled to get the amount of claim only from the original insurer and not from reinsurer.

5. Original insurer cannot insure the risk with a re-insurer, more than the sum assured, originally by the insured.

6. The original insurer should intimate to the reinsurer about the alteration, if any, made in terms and conditions with the insured.

Note:

Reinsurance is not coinsurance

Reinsurance is not banking- it is not lending of money but it can have the same effect.

Reinsurance is not a security.