BBA-101

PRINCIPLES OF MANAGEMENT AND ORGANIZATIONAL STRUCTURE

DIRECTORATE OF DISTANCE EDUCATION

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SYLLABUS

BBA 1st Year 1st Semester

Principles of Management and Organization Structure

Course Code: BBA- 101		
Course Credit: 04	Lecture: 04	Tutorial: 1
Course Type: BBA	Core Course	
Lectures delivered:	30 L + 10 T	

End Semester Examination System

Maximum Marks Allotted	Minimum Pass Marks	Time Allowed
70	28	3 hrs

Continuous Comprehensive Assessment (CCA) Pattern

Minor Tests(marks)	Assignment/ Tutorial/ Presentation	Attendance	Total
15	5	10	30

Course Objective:

- This course is designed to provide students understanding basic Principles and concept of Management.
- To provide an overview of the major functions of management.
- Emphasis is on planning, organizing, controlling, directing, and communicating.

UNIT	Content	Hours
I	**EVOLUTION OF MANAGEMENT THOUGHT** CLASSICAL SCHOOL: F. W. Taylor: Scientific Management Theory, Classical Organisation Theory, Fayol's Principles of Management, And MaxWebers' Bureaucratic Model. BEHAVIOURAL SCHOOL: Mary Parker Follet, Chester Bearnard,	12
	HowthorneStudies.	
II	**MANAGEMENT FUNCTIONS AND PLANNING** Basics management functions, role of manager Overview of Planning: Types of Plans & The planning process; Decision making: Process, Types and Techniques. Control: Function, Process and types of Control;	12
III	**ORGANISING & COORDINATING WORK:** Principles of organizing: Common organisational structures; Delegation & Decentralization: Factors affecting the extent of decentralization, Process and Principles of delegation.	12
IV	**OWNERSHIP** Basic forms of Business Ownership; Special forms of ownership: Franchising, Licensing, Leasing; Choosing a form of Business ownership; Corporate Expansion: mergers and acquisitions, diversification, forward and backward integration, joint ventures, Strategic alliance.	12
V	**STAFFING** Concept of staffing - Recruitment and Selection; Orientation; Training and Development; Career Development; Performance Appraisal.	12

Course Outcomes:

1. Evaluate the global context for taking managerial actions of planning, organizing and controlling.
2. Demonstrate critical thinking when presented with managerial problems and express their views and opinions on managerial issues in an articulate way.
3. Understand basic concepts of organisational structure
4. Explain the advantages and disadvantages of centralised and decentralisedorganisations.
5. Analyse organisations in terms of theories, concepts, and design factors
6. Engage in research and inquiry to design problem solutions supported by analysis of contemporary practice.
7. Work independently and collaboratively to analyse organisational structure, reflect upon, and communicate the outcomes of each project stage.

Text Books:

1. Principal and Practice of Management :L.M. Prasad
2. Business Organisation &Management : Singh & Chhabra

Reference Books:

1. Essentials of Management: Koontz 'O' Donnel
2. Management: Stephen P. Robbins
3. Functions and Process of Management: J. K. Jain

Weblinks

https://www.tutorialspoint.com/management_principles/management_principles_tutorial.pdf
https://study.com/academy/lesson/organizational-structure-definition-types-examples.html
http://www.pearsoncanada.ca/media/highered-showcase/multi-product-showcase/robbins-ch05.pdf

UNIT 1 EVOLUTION OF MANAGEMENT THOUGHTS

NOTES

★ STRUCTURE ★

1.1 Administration and Management
1.2 Levels of Management
1.3 Development of Management Thought
1.4 Bureaucracy
1.5 Hawthorne Studies
- Summary
- Review Questions

1.1 ADMINISTRATION AND MANAGEMENT

Management is a specialized activity required for the running of those social institutions which are composed of a group of human beings. The same management functions are to be found everywhere and as such, the management skill is transferable from one kind of social institution to another. Usually, this specialized ability is called "management" in business institutions and "administration" in others. The attempt to draw a distinction between "business administration" and 'business management' is thoroughly misleading and all recent studies have tried to avoid it as far as practicable. That there is no distinction even between management and public administration was pointed out by Fayol in his address to the Second International Congress of Administrative Science "All undertakings require planning, organization, command, co-ordination and control and in order to function properly, all must observe the same general principles. We are no longer confronted with several administrative sciences, but with one which can be applied equally well to public and private affairs". Persons who discharge management functions are universally called 'executives' but in business they are further known as 'managers'.

1.2 LEVELS OF MANAGEMENT

In the past, the two broad levels of management used to be denoted by administrative management and operating management. The upper level of management was usually called "administrative management" and the lower level was known as "operating management". The use of these terms implies a division of the management functions into two separate groups, viz., thinking functions and doing functions. As pointed out earlier, fundamental management functions are undertaken by all

managers, irrespective of their leels or ranks. Accordingly, it does not fit into the facts of the real life to draw any line of separation between thinking functions and doing functions. Furthermore, the use of these terms stems from the acceptance of two different social sciences management and administration which are not existing in fact.

The current practice is to denote the upper level of management by the term "top management". The lower level or echelon of management goes by the name of "middle management". The adoption of the term middle management undoubtedly suggests that there is a further level below it. Actually, the lowest level is composed of foremen and supervisors who also perform precisely the same management functions of planning, organizing, directing and controlling in differing degrees. To be sure, whoever performs the basic functions of management are to be called 'managers' in the technical sense of the term since their functions can be sharply distinguished from those of non-managers.

Levels of management become prominent in large-sized public limited companies. Three distinct levels of management along with their respective functions are stated below:

1.2.1 Top Management

Top management of a company is constituted by its or board of directors and the chief executive. Functions of top management include (1) to make an outline of planning through the formulaton of basic objectives and policies of the company, (2) to determine the basic pattern of the company's organization structure, (3) to arrange for effective co-ordination of all activities, (4) to make staffing of departmental and other important executives, (5) to prepare overall budgets and programmes for short-range and long-range operations, (6) to exercise overall control in respect of all operations, (7) to ensure continuity of the company through modernization and innovation of material resources and the executive development of human resources and (8) to maintain public relations with all outside parties for improving the company's image and protecting its interests.

1.2.2 Middle Management

Between top management and supervisory management, there is found to exist another level of management known as middle management. In large enterprises, middle management is bifurcated into two parts upper middle or intermediate management and lower middle management. Middle management is constituted by divisional, departmental and sectional managers and its functions include (1) to develop derivative objectives and policies and to prescribe procedures and methods in different areas, (2) to prepare departmental budgets and programmes in the context of overall planning, (3) to execute plans through orders, instructions and advice, (4) to exercise control in different areas through the application of quality standards and cost standards and (5) to effect co-ordination between top management and supervisory management.

1.2.3 Supervisory Management

Supervisory management is the lowest level of management and it is constituted by superintendents, foremen and inspectors. There are six important functions of supervisory management : (1) to supervise the actual operations through guidance, checking and overseeing, (2) to translate the plan into actions through the provision of facilities and resources and the creation of a favourable work environment, (3) to exercise control over the work-in-progress through applying quantity standards and time standards, (4) to send information and progress reports to higher management, (5) to motivate the personnel for improving productivity of the company and (6) to put all the managerial orders, instructions, policies and programmes into action and to make higher managerial accomplishments.

1.3 DEVELOPMENT OF MANAGEMENT THOUGHT

Management has become today a theory jungle by the contributions of scholars and writers from several disciplines like sociology, psychology, social psychology, cultural anthropology, political science, engineering, economics, mathematics, statistics and others. Having different backgrounds and adopting divergent approaches, these contributions have created a diversity in management thought. To understand the present state of management, it becomes necessary to trace the history of management thought. Management has been progressively developed through the following seven schools of thought.

1. Scientific Management. F.W. Taylor is the founder of scientific management at the turn of this century. Taylor's ideas on scientific management took a tangible shape through the publication of his famous work, the Principles of Scientific Management in 1911. Apart from Taylor, other contributors to scientific management include Frank B. Gilbreth, Morris L. Cooke, Henry L. Gantt and Harrington Emerson. Gilbreth contributed to scientific management through motion study as Taylor did through time study. Morris Cooke wrote about the applicability of the principles and techniques of scientific management to non-business institutions like municipalities and universities.

2. Management Theory : Henri Fayol of France was the first of management theorists who were concerned with the principles of organization and the functions of management. Through his well known work General and Industrial Management, published in French in 1916, Fayol laid the foundation of management as a separate body of knowledge and viewed that management had universal application to all forms of group activity. Other important contributors to this school of management thought are Max Weber, Oliver Sheldon, James D. Mooney, Lyndall Urwick, Chester I. Barnard and Herbert A. Simon.

3. Human Relations. After the pioneering work of Mary Parker Follett on group behaviour and group dynamics, the conclusions of Hawthorne study were published by Elton Mayo and his associates in the latter

1930s and throughout the 1940s. Mayo's conclusions were that human behaviour is moulded by feelings or sentiments, that the group exercises a strong influence on individual behaviour and output, and that the financial incentive is less powerful than group standards and sentiments in determining output. Briefly, the Hawthorne study established that human beings are the most important and influential input for securing a greater output in any concern. Other contributors to this school of thought include Kurt Lewin, F.J. Roethlisberger and T.N. Whitehead.

4. Decision Science : In the 1950s, the contributions of economists, mathematicians and statisticians, or economietrists as they are jointly called, led to the development of another school of management thought which is known as decisionscience school. It is concerned with rational decision making by way of defining the problem, developing alternatives, evaluating such alternatives, and choosing the best possible solution thereof. According to this school, as decision making is the sole way in which managers can discharge their responsibility of managing, decision making should be taken as the central focus of the management study. Various mathematical models and analyses like linear programming, critical-path scheduling, inventory models, information models, simulation, etc. have been developed for quantitative measurement of decision results with the help of computers. Important contributors to this field include Herbert A. Simon, Russel Ackoff, Joy Forrester, Martin Starr and Kenneth Boulding.

5. Behavioural Sciences : Along with the growth of decision science school, there arose the behavioural sciences school after the World War II. Ideas of Mary Parker Follett, Chester I. Barnard and Elton Mayo were greatly extended by behavioural scientists. Reversing the findings of the human relations school which viewed that happy workers were productive workers, the behavioural sciences school puts emphasis on human behaviour as it relates to the goal achievement and efficiency improvement. With this end in view, behavioural scientists are mostly concerned with organizational change, motivation and leadership. This school contributes to our knowledge of organizational behaviour by showing the way of integrating individual goals with the organizational goals and of managing interpersonal conflicts. Important contributors to this school of thought include Herbert A. Simon, James G. March, Douglas McGregor, Chris Argyris, George C. Homans, Rensis Likert, Abraham Maslow, Frederick Herzberg, Joe Kelly and others.

6. Systems Theory. To reconcile the divergent views and approaches adopted in different schools of thought, the systems theory has been developed from the 1960s for integrating the past and present contributions by way of a systems aproach and for explaining the complexity and dynamicity of present-day organizations. The systems concept enables us to see the critical variables and constraints and their interactions with one another. Herbert A. Simon is the spiritual father of this school. Other major contributors to this school of thought are Daniel Katz, Robert L. Kahn and Richard A. Johnson.

SYSTEMS APPROACH. A system is defined as a set of regularly interacting or inter-dependent components that go to constitute a united whole. A series of flows connects the components and provides the means by which the components interact with one another. The systems approach to management has the same characteristics as are found in physical and biological systems. The systems have five essential characteristics. First, systems must have some specific components, parts, units or subunits which are called sub-systems of the system. The marketing unit, for example, is a subsystem of the enterprise system. Secondly, every system is encompassed, affected or influenced by a larger system which is called the suprasystem. Thirdly, all systems along with their subsystms must have some common objectives for unifying the components through their interrelationships. Fourthly, systems are of such a complex character that a change in one subsystem affects the other subsystems. Finally, all systems must receive inputs to survive and these inputs must be processed into outputs at such a rate that they maintain the viability of the system.

7. Contingency Theory. Allied to the systems theory, the contingency theory calls for a further refinement, extension and synthesis of past and present contributions in the sphere of management. The contingency view requires a consistency between the organization and its environment and among the various subsystems. Current management thinking is greatly influenced by both the systems approach and the contingency approach. These two approaches are recognized as the key to effective management in the 1980s. Both these approaches accept the dynamics and complexities of the organization structures and of the behaviour of their members. Important contributors to the contingency theory include Tom Burns, G.M. STalker, Joan Woodward, Paul R. Lawrence, L.W. Lorsch, Victor H. Vroom and Robert J. House.

CONTINGENCY APPROACH. The most recent development in the theory of management is what is known as the contingency theory or the situational approach. In all its operations, an organization affects and is affected. In all its operations, an organization affects and is affected in turn by its environment. The environment is composed of persons, physical resources, ecnomic and market conditions, climate, culture, attitude and laws. The environment exercises a potent influence on the enterprise and sets opportunities and limitations for the organization. Any successful organization recognizes the important environmental factors and tries to mould other factors. As a result, effective managerial principles and practices vary with the environment in which the organization operates, and any generalizations of principles are not practicable. In the sphere of organization design, leadership and motivation, the contingency approach to organizations has modified the traditional thinking on such matters. According to this approach, the organization structure, leadership styles and motivation patterns are contingent on the task, technology and environment of the organization.

Contributors from the UK. As regards the important contributors from the U.K. Boulton and Watt introduced in 1796 Production Management by way of work study, production planning, payment by results and cost-accounting procedure. Robert Owen adopted a pioneering step in 1810 in the field of Personnel Management. Charles Babbage busied himself with an improved use of machines and the organization of human beings and published a work on the Economy of Machinery and Manufacturers in 1832. During the present century, a comprehensive work on management is The Philosophy of Management written by Oliver Sheldon in 1923. Besides, several publications of Lyndall Urwick and E.F.L. Brech have enriched our management knowledge.

Contributors from the U.S.A. In the U.S.A., Taylor's ideas on scientific management were greatly extended by his three important disciplies, viz., Henry L. Gantt, Frank Gilbreth and Harrington Emerson. Contributions from businessmen include Lectures on Organization by Russel Robb in 1910; a publication entitled Organization Engineering by Henri Dennison in 1931; a comprehensive theory of organization under the title of Onward Industry by Mooney and Reiley in 1931; and Chester I. Barnard's book, The Functions of the Executive published in 1938. Barnard's book is recognized as a landmark in management thinking for introducing social aspects in the management process. The results of Hawthorne Research have been published by three important researchers, viz., Elton Mayo, F.J. Roethlisberger and T.N. Whitehead. Herbert A. Simon is the most important and versatile contributor to management thought over a period of three decades. He contributed to management from mathematics, cybernetics and computers approaches as well as from psychological, sociological and economic viewpoints. His book, Administrative Behaviour, is a modern classic on decision making. His another book, Organizations, equally proved his genius for integrating behavioural sciences into management thinking. He is the only Nobel prize winner in the management area. Peter F. Drucker is the most objective and prolific management analyst of the present time. Drucker is currently exercising a major influence on management thinking and practice by his several publications and many of his ideas have become the basic tenets of management at present. Last but not the least, the influence of the American Management Association and the Society for the Advancement of Management is tremendous on the growth of the management theory. Moreover, a galaxy of political scientists, sociologists, psychologists and anthropologists have made some significant contributions in recent years. Of all the social scientists, the name of Mary Parker Follett deserves special mention.

Mary Parker Follett (1868-1933). Follett has made valuable contributions through books and papers on group dynamics, human relations and authority exercise, some of which bear a stiking similarity with Hawthorne Experiments published in a subsequent period. She pointed out that any human group has a life of its own which is something

more than the sum of the individual lives composing it and that the individual's thoughts and actions are always moulded by the group influence. In all co-operative endeavours, the group adds a plus value when properly directed. Conflicts between persons or between groups stem from differences which can be used as an avenue towards, and a vehicle of progress when such differences are integrated rathern than compromised or suppressed under domination. Exercise of authority is involved in leadership, control as well as in the execution of decisions and orders. In all such situations, the employee acceptance of authority would be satisfactory provided "Law of the Situation" is explained through the systematic presentation of facts. Briefly, instead of imposing power over people, the use of authority and the task of order giving should be depersonalised.

Taylor F.W. (1856-1915). Taylor is well known for his famous work, The Principles of Scientific Management, published in 1911. Although the work was professed to provide general principles of management, it was in reality found to contain certain principles of factory management or production management. To improve the productive efficiency of industrial concerns, he was preoccupied with machines and their operators. With this end in view, he developed time and motion study which was regarded as the "cornerstone of scientific management." The central theme in Taylor's work was the advocacy for separation of planning functions from doing functions, management taking more and more thinking functions from workers so as to make their work purely mechanical through the formulation of rules, laws and formulas. His insistence on the application of scientific methods or "one best way of doing jobs" are the principal contribution to management theory. His ideas on selection, training, compensation and discipline of workers have some rudiments of validity. He placed several new duties on management in the form of principles: (a) replacement of the old rule-of-thumb method by scientific one through the exact determination of each man's work on the basis of elementary motions or operations ; (b) scientific selection, placement and training of workers; (c) absolute co-operation between labour and management in the performance of work ; and (d) equitable division of work and responsibility between management and labour.

Taylor's scientific management inundated the whole industrial world in a sudden flood which, however, receded back in course of time. Taylorism has become a dead cult now for two misconceptions. Subsequent studies have revealed that complete separation of planning from doing under his functional foremanship is out and out an unrealistic principle. Secondly, the assignment of mechanical job to workers by breaking a task into elementary components is thoroughly unproductive, since it denies job-satisfaction to workers and makes them inanimate cogs in the industrial machinery. Organized labour misunderstood it as a device for speeding-up and rate cutting. Moreover, the claim of Taylor and his disciples that theirs was an "exact science" has be littled the importance of it. Rather than providing fundamental principles of general management,

Taylorism is now held to be responsible for delaying the propagation of a true management science developed by Henri Fayol in 1916. That the Americans even now use the term scientific management can be explained historically. Taylorism is nothing but shadow of the present-day concept of scientific management even in the U.S.A.

Fayol, Henri (1841-1925). Henri Fayol, the French industrialist, is regarded in responsible quarters as the real father of management science. After graduating himself as a mining engineer in 1860, he immediately joined a coal mining company as its engineer and was promoted to the position of its Managing Director in 1888 for his conspicuous ability. When he became the chief executive of the company, it was on the verge of collapse. Under his leadership over a period of 30 years, the company came out as one of the largest coal and iron combines in the country with an exceptionally strong financial position. As a successful industrialist, Fayol had the opportunity to search for sound management principles and was able to analyse the management process correctly in course of his two lectures delivered in 1900 and 1908. Subsequently he tried to reduce his ideas into a coherent philosophy by the development of principles through his famous work, General and Industrial Management, published in French in 1916. From the date of his retirement in 1918 till 1925, he devoted himself to the task of popularising his theory of management in France.

The relative contributions of these two pioneers have been reviewed by Urwick in his foreword to the English translation of ***General and Industrial Management*** in the following words : "The work of Taylor and Fayol was of course, essentially complementary. They both realized that the problem of personnel and its management at all levels is the 'key' to industrial success. Both applied scientific method to this problem. That Taylor worked primarily on the operative level, from the bottom of the industrial hierarchy upwards, while Fayol concentrated on the Managing Director and worked downwards, was merely a reflection of their very different careers. But Fayol's capacity to see and to acknowledge this publicly was an example of his intellectual integrity and generosity of spirit. They gave France a unified management body more than twenty years before the same ideal began to be realized in Great Britain." Although Taylorism has undergone a profound change under the impact of new developments, Fayol's principles have stood the test of time and have been accepted as the core of management theory even upto the present time.

1.4 BUREAUCRACY

Max Weber's contribution to management is in the area of authority structures and has description of organization based on the nature of authority relations within them. Webproposed and studied Bureaucracy as a form of organization. According to Weber, bureaucracy is a highly structured, formalized, and impersonal organization. The following are the dimensions or characteristic of **Webrian Bureaucratic model:**

1. The division of labour and the assignments of responsiblity and authority are clearly defined. Thus. a division of labour, rights, and power are essential for rational organizations.

   To carry out his duties efficiently, an individual must know the limits of his job, rights, and power and any overstepping will create confusion in the whole structure.

2. A system of rules control and regulate all behaviour in the organization. Rules provide standardization, equality, and save time and effort in the treatment of many eases.

3. A well-defined hierarchical structure and authority. Each lower level in the organizational structure is under the control of a higher level, thus providing vertical integration in the organization. Weber emphasizes rational-legal authority.

4. A system of procedures for dealing with the situation. These procedures arc recorded in writing.

5. Selection strictly based on the candidate's technical competence and not on nepotism. Promotions are decided on seniority and achievement. Employment in the organization is viewed as a life-long career and required a high degree of loyalty.

6. Separation of conduct of business operations from personal affairs. The employee's bureaucratic status should not be infringed by the demands of his non-organizational or personal statuses.

The above dimensions of bureaucracy would exist to a greater degree in the "ideaf type of bureaucratic organizations. In less bureaucratic organizations, these dimensions would be seen to a similar degree. So far we have examined some significant contributions. There are a countless number of others who have also made contributions to the theory and practice of management. Robert Owen for instance, advocated for more attention to the human being in the industrialization process. Charles Babbage stressed the importance of the division of physical and mental labour, suggested the ideas of profit sharing, anil begun observing and timing work. Charles Dypin's contribution lies in the area of management education. Luther Gulick conducted research in the application of scientific approach to public administration.

1.5 HAWTHORNE STUDIES

In the 1920s and 1930s, observers of business management began to feel the incompleteness and short-sightedness in the scientific as well as administrative management movements. The scientific management movement analysed the activities of workers whereas administrative management writers focused attention on the activities of managers. The importance of the man behind the machine, the importance of individual as well as group relationships in the workplace was never recognised.

The social aspects of a worker's job were totally ignored; the emphasis was clearly on discipline and control rather than morale. The human relations theory (also called neo-classical theory) tried to compensate for the deficiencies in classical theory (scientific management and administrative inanagement) modifying it with insights from behavioural sciences like psychology, sociology and anthropology. This theory gained popularity after the famous studies of human behaviour in work situations conducted at the Western Electric Company from 1924 to 1933. These studies eventually became known as the 'Hawthorne Studies' because many of them were conducted at Western Electric's Hawthorne plant near Chicago.

1.5.1 Hawthorne Experiments

- ***Illumination experiments:*** The Hawthorne researchers began with illumination experiments with various groups of workers. This experiment involved prolonged observation of two groups of employees making telephone relays. The purpose was to determine the effects of different levels of illumination on workers' productivity, The intensity of light under which one group was systematically varied (test group) while the light was held constant (control group) for the second group. The productivity of the test group increased each time the intensity of the light increased. However, productivity also increased in the control group, which received no added light. The researchers felt that something besides lighting was influencing the workers' performance. In a new set of experiments, a smalt group of workers were placed in a separate room and a number of things were changed; wages were increased, rest periods of varying length were introduced; the workday and workweek were shortened. The researchers, who now acted as friendly supervisors, allowed the group to choose their own rest periods and to have a say in other suggested changes. Workers in the test room were offered financial incentives for increased production. Over the two year period, output went up in both the test and control rooms (surprisingly, since the control group was kept on the same payment schedule) steadily regardless of changes in working conditions. Why?
- ***Hawthorne Effects:*** Part of the answer may be attributed to what has come to be called the 'Hawthorne Effect'. The workers knew they were part of an experiment. They were being given special attention and treatment because of the experiment. They were consulted about work changes and were not subject to the usual restrictions imposed from absve. The result of this special attention and recognition caused them to carry a stimulating feeling of group pride and belongingness. Also, the sympathetic supervision received by the members might have brought about improved attitudes toward their jobs and job performance. At this stage, the researchers were interested in finding out clear answers to the question: Why the

attitudes of the employees had become better after participation in the test room?

NOTES

- ***Interviewing ftrogrammt:*** Mayo initiated a three year long interview programme in 1928 covering more than 21,000 employees to find out the reasons for increased productivity. Employees were allowed to talk freely (non-directive interviewing) and air their opinions in a friendly atmosphere. The point demonstrated by this interviewing programme is central to the human relations movement. If people are permitted to talk about things that are important to them, they may come up widi issues that are at first sight unconnected with their work. These issues may be, how their children are doing at school, how the family is going to meet the ration expenses, what their friends think of their jobs, and so on. Talking about such matters to a sympathetic listener who does not interpret is therapeutic. When researchers began to examine the complaints made by the employees they found most of the complaints baseless. Many times nothing was done about the complaint, yet, after an interview the complaint was not made once again. It became apparent that often workers really did not want changes to be made; they mainly wanted to talk to an understanding person who did not criticise or advise about their troubles. Thus, for the first time, the importance of informal workgroups was recognised. To find out more about how the informal groups operated, the bank wiring room experiment was set up.
- ***Bank wiring room experiments:*** In this experiment, 14 male workers were formed into a small workgroup and intensively observed for seven months in the bank wiring room. The men were engaged in the assembly of terminal banks for the use in telephone exchanges. The employees in the group were paid in the regular way depending on the efficiency rating plus a bonus based on average group effort. Thus, under this system, an individual's pay was affected by the output of the entire group and by his own individual output. It was expected that highly efficient workers would bring pressure to bear on less efficient workers in an attempt to increase output and thus take advantage of the group incentive plan. However, these expected results did not come about. The researchers found that the group had established its own standard of output and this was enforced by various methods of social pressure. Output was not only being restricted but individual workers were giving erroneous reports. The group was operating well below its capability and was levelling output in order to protect itself. Thus, workgroup norms, beliefs, sentiments had a greater impact in influencing individual behaviour than did the economic incentives offered by management.

1.5.2 Human Relations Key Concepts

The Hawthorne experiments, thus, indicated that employees was not only economic being, but social and psychological beings as well. The man at work is motivated by more than the satisfaction of economic needs. The main emphasis should be on creating a humanistic or informal organistation in place of a mechanistic of formal organisation. The organisation must be democratised and people working therein must become part of 'one big happy family'. In the works of Keith Davis, 'Human relations are motvating people on organisations in order to develop teamwork which effectively fulfils their needs and achieves organisational goals'.

SUMMARY

- The upper level of management was usually called "administrative management" and the lower level was known as "operating management". The current practice is to denote the upper level of management by the term "top management". The lower level or echelon of management goes by the name of "middle management".
- A system is defined as a set of regularly interacting or inter-dependent components that go to constitute a united whole. A series of flows connects the components and provides the means by which the components interact with one another.
- The organization structure, leadership styles and motivation patterns are contingent on the task, technology and environment of the organization.
- Max Weber's contribution to management is in the area of authority structures and has description of organization based on the nature of authority relations within them. Webproposed and studied Bureaucracy as a form of organization. According to Weber, bureaucracy is a highly structured, formalized, and impersonal organization.
- The scientific management movement analysed the activities of workers whereas administrative management writers focused attention on the activities of managers.
- The human relations theory (also called neo-classical theory) tried to compensate for the deficiencies in classical theory (scientific management and administrative inanagement) modifying it with insights from behavioural sciences like psychology, sociology and anthropology.
- The Hawthorne experiments, thus, indicated that employees was not only economic being, but social and psychological beings as well. The man at work is motivated by more than the satisfaction of economic needs.

REVIEW QUESTIONS

1. Define Administration and Management.
2. Explain the different levels of management.
3. Differentiate Administration with management.
4. Explain the various schools of management thoughts.
5. Discuss the characteristics of Weberian Bureaucratic Model.
6. Write short notes on:
   (a) Level of Management
   (b) Contribution of Mary Parker Fallett
   (c) Contribution of Fayol Henri
   (d) Contribution of Taylor F.W.
   (e) Hawthrone studies

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UNIT 2 PLANNING

★ STRUCTURE ★

2.1 Introduction
2.2 Meaning and Definition of Planning
2.3 Nature/Characteristics/Features of Planning
2.4 Importance/Advantages of Planning
2.5 Limitations of Planning
2.6 Stages/Steps/Process of Planning
2.7 Types of Plans
2.8 Introduction & Definitions of Decision-Making
2.9 Importance of Decision-Making
2.10 Factors involved in Decision-Making
2.11 Types of Decisions
2.12 Common Difficulties in Decision-Making
2.13 Guidelines For Effective Decision-Making
2.14 Decision-Making—The Quantitative Way
- Summary
- Review Questions

2.1 INTRODUCTION

Every business enterprise has its own predetermined objectives to be achieved. In order to achieve the objectives in the best possible manner, it requires a lot of mental exercise based upon imagination, foresight and judgement for deciding the tasks to be undertaken and the techniques to be adopted. No doubt, the success lies in the effective and sound planning, which undoubtedly determines the future course of action.

In case, we do not plan our future activities, we shall pursue disorderly line of action, adopt 'hit or miss' method and meet the failure. We shall identify the mistakes committed in the process of action at a very late stage after wasting a lot of resources. It emphasises that the efficient management must foresee the future, determine the goal, take into consideration its available resources, socio-economic environment and plan its course of future action.

2.2 MEANING AND DEFINITION OF PLANNING

Planning is the process which helps in bridging the gap between where we are and where we want to go.

Planning is to decide future course of action. It is the very first function of management. *Planning is a systematic activity which determines, when, how and who is going to perform a specific job.* It is a sort of detailed programme, regarding task to be completed in future. It studies and analyses the work to be done, makes the arrangement of requisite men, machine, material, money and methods, so that the job may be completed effectively. It is rightly said that *well planned is half done*, because planning takes into consideration the available and prospective human and physical resources of the organisation and gets their effective coordination, requisite contribution and perfect adjustment. Planning in this way is concerned with both the process of determining the objectives of business and electing the most suitable course of action. It is, really *looking ahead and preparing for future.* It should be never taken as isolated. It is really a never ending activity because of its positive co-relationship with business, which is a continuing process.

Definitions of Planning

"Planning is a mental predisposition to do things in orderly way, to think before acting and to act in the light of facts rather than guess."

—Urwick

"Planning is deciding the best alternative among others to perform different managerial operations in order to achieve the predetermined goal."

—Henri Fayol

"Planning is selecting and relating of facts in the visualisation and formation of proposed activities believed necessary to achieve desired results."

—George R. Terry

"Planning is a thinking process, the organised foresight, the vision based on fact and experience, that is required for intelligent action."

—Alford and Beaty

The problems of planning situation are rightly indicated by **Rudyard Kipling** in the following words:

I keep six honest serving men,
They taught me all I know.
Their names are *what, where* and *when*,
And *how* and *why* and *who*.

It shows that planning is concerned with the following:

(*i*) What is to be done? (*ii*) Where is it to be done?

(*iii*) When is it to be done? (*iv*) How is it to be done?

(*v*) Why is it to be done? (*vi*) Who is to do it?

In this way, planning is the response, we get against the above six questions.

We may now safely conclude that *planning is a continuous intellectual process, based upon facts to decide, arrange and coordinate the available and prospective physical and human factors in the best possible way to achieve predetermined goal of the enterprise.*

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2.3 NATURE/CHARACTERISTICS/FEATURES OF PLANNING

An effective planning is the key to success, so it is necessary tha an efficient management must take into consideration the followin characteristics of management.

1. **Planning is the primary function of management.** Th management has to formulate plans first and afterwards it ha to make arrangement of necessary resources, select and appoin the most suitable persons for every specific job and direct thei efforts and energies towards desired goal. The actual performanc is compared with the planned performance, to discover deviation and finally apply remedial measures. Necessary adjustments i the plans may also be made if required.
2. **Planning is goal oriented.** Planning is made to achieve th desired objectives of the business. The goal established should hav general acceptance otherwise individual efforts and energies wil be misguided and misdirected. Management being a team work effective coordination and adjustment of individual and grou efforts towards the cherished goal of the business is necessary As such planning contributes to objectives.
3. **Planning is an intellectual process.** A good plan is based upo collection, study and analysis of the requisite facts, evaluatin alternative combination of factors and deciding the most appropriat line of action, depending upon the ability and intelligence of th management.
4. **Planning is pervasive.** Planning is essential for every sort o business activities. Every department whether, Purchase, Sales Accounts, Auditing, Marketing etc. needs systematic planning. Coordination of different departmental plans and direction o their integrated energies towards the desired goal of the business depend on planning. Effective organisation, staffing, direction and controlling needs planning. Planning in this way, is all-embracing.
5. **Planning involves decision making.** Planning is choice making of the best possible alternative out of the various alternatives. In order to accomplish the predetermined objective of the business, there can be various alternative possible courses of action. Every line of action has its own plus and minus points. Planning studies and evaluates every alternative with reference to its needs and resources. Finally it decides the most suitable line of action to be adopted by the enterprise.
6. **Planning is futuristic.** No doubt, we always plan for future. We anticipate future requirements and availability of resources. While determining the future demands, we have to take into consideration the existing and prospective resources of the business and fiscal,

monetary and industrial policy of the Govt. Plans are always put to practice in future. It is only a setting, thinking and arrangement in advance for the future. Planning in this way is looking ahead.

7. **Planning does not eliminate future risk but enable us to face it.** What is fate cannot be averted? Planning presumes certain general uncertainties but unforeseen natural calamities cannot be predicted and as such there is always risk and we can never claim to have eliminated it. Planning only prepares the enterprise to face uncertainties and reduce the adverse effects of uncertainties. Planning may presuppose certain future events and suggest measures to face it.
8. **Planning is a continuous process.** Planning always continues in the organisation in one or the other form. The actual business situations may demand certain amendments or moderations in the plans, therefore, plans are modified. The controlling may also point out certain deficiencies in the plans and they are framed accordingly. The completion of one plan requires the other plan to be undertaken. In this way, planning is a continuous process.

2.4 IMPORTANCE/ADVANTAGES OF PLANNING

Planning is beginning and end of all managerial activities. It is involved in all managerial functions, *i.e.,* planning, organising, staffing, directing and controlling. All sorts of organisation, whether business, social, political, religious and culture have to plan their future activities. An effective planning of business activities means the achievement of objectives efficiently with lesser wastage of resources and energies. The importance of planning in management can be justified on the following grounds:

1. **Planning provides directions.** Planning anticipates future demands and evaluates existing and prospective resources. Planning provides direction by stating in advance how work is to be done. Planning ensures that goals are clearly stated so that the people of the organisation should know what to do and in which direction. It goals are well stated it helps directing towards the desired goal of the business.
2. **Planning reduces the risk of uncertainty.** It is the planning which pre-assesses the future uncertainties and also enables the organisation to face these uncertainties with minimum wastage of resources. In the absence of planning for future uncertainties, the losses being suffered may be greater.
3. **Planning reduces overlapping and wasteful activities.** Planning evaluates the alternative uses of the available and prospective resources of the business and makes their most appropriate use. It is the planning which determines the specific use of individual resources. The best possible use of the business resources reduces its misuse and wastage and therefore, results in an economy.

4. **Planning promotes innovative ideas.** Planning as a primary function of management promotes innovative ideas. It can take the shape of concrete plans. It is the main challenging activity for management as it drives the future actions leading to growth of the business.
5. **Planning facilitates decision-making and promotes creativity.** Planning assesses future requirements. In order to avail of the opportunities in an appropriate way concerted efforts are made and as such new ideas, methods and techniques emerge.
6. **Helpful in development and expansion.** Planning tries to avail of all the opportunities available by making the effective utilisation and integration of resources, which make the expansion of business easy.
7. **Planning establishes standards for control.** Planning helps in determining the authorities, responsibilities and duties of individual employees. It has predetermined goal with which the actual performances are compared to find out deviation and suggest remedial measures.

2.5 LIMITATIONS OF PLANNING

Planning, no doubt, is very useful for the business enterprise but it does not mean that it is the remedy of all the deficiencies of the business. Planning in itself may be defective. Now, let us consider the limitations of planning:

1. **Planning puts managerial activities in a rigid framework and creates false sense of security.** Planning depends upon forecasting, which can never be cent per cent correct. Management is committed to execute plans, so independent thinking and the initiative of the management suffers. Defective plans prove fatal to the security and safety of the enterprise. Planning makes business operations inelastic. The business situations change rapidly. New methods, techniques and equipments are invented but the enterprise cannot take the advantage of these inventions and discoveries.
2. **Planning may not work in a dynamic environment.** Business operates in a dynamic environment, nothing is constant. Planning anticipates future. It takes into consideration the possible changes in economic, political, physical, legal and social dimensions. If these changes are not expected, planning becomes ineffective. The organisation has to adapt to changes. Unexpected changes in the technology of production and marketing etc., make the plan unsuccessful.

3. **Planning reduces creativity.** Planning strangulates the initiative of workers and compels other members to work with inelastic method. The employees have to work in conformity with plans and therefore it is incompetent to avail oneself of the existing opportunities. Thus, much of the initiative or creativity inherent in them also get lost or reduced.
4. **Planning involves huge costs.** Collection, analysis and evaluation of the different information, facts and alternatives involve a lot of expenses. According to Koontz O'Donnel expenses on planning should never exceed the estimated benefits from planning.
5. **Time consuming device.** Planning process *i.e.,* from collection of data to the suggestion of the best alternative consumes a lot of time and energies.
6. **Planning does not guarantee success.** Planning is based upon the anticipated fiscal and industrial policies. Planning should be properly executed for the success of the business. Any plan needs to be translated into actions or it becomes meaningless. Managers cannot rely upon the previously tested successful plans. It is not necessary that a plan was successful before then it will be successful again. Therefore, planning does not guarantee success but provides a base for analysing future course of action.
7. **Machinery of planning can never be free from bias**. Every planner has its own likes, dislikes, preferences, attitudes and inerests, which are reflected in the plans. If the planning machinery itself is biased, plans may not suit the general interest of the enterprise.
8. **Unsuitability for certain business.** Certain businesses like fashionable articles, where situations change rapidly, planning has limited scope. In a small business house which is itself short of finance, planning will prove to be a burden.

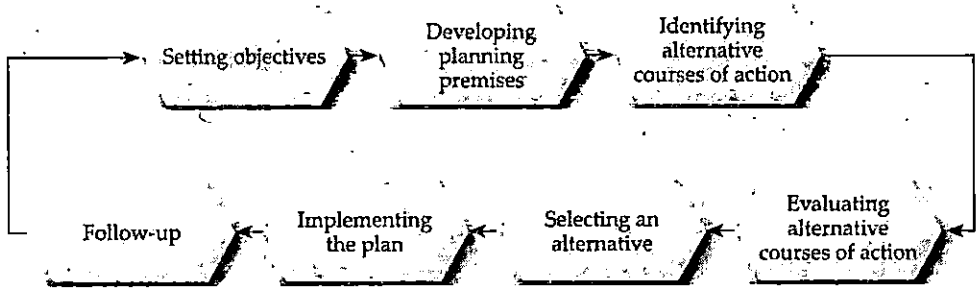
2.6 STAGES/STEPS/PROCESS OF PLANNING

The success of business depends upon effective planning to a greater extent. A good planner estimates in advance the future opportunities and channelises the existing and prospective energies of the business to avail himself of the maximum benefit from the opportunities. There will be different plans to meet different situations in different types of business but logical and scientific planning must go through the following steps:

1. **Setting objectives.** In order to begin with the plan a clear and definite objectives of the organisation is necessary. Plans are always made to solve business problems, to attain a certain specific objective or to avail oneself of the benefits expected from any anticipated opportunity. Thus the first step in the planning is identification and recognition of the problem, requirement and

opportunity. Identification of the problem and opportunity must be in accordance with defined organisational objectives.

2. **Developing planning premises.** Planning is always based upon certain estimates and forecasts, which can never be cent per cent accurate. There are certain limitations, which can be taken note of. Examples of these limitations are the rate of population growth, general economic conditions, fiscal and industrial policies etc.
3. **Identifying alternative courses of action.** After setting up the objectives, an organisation identifies the alternative courses of action through which the organisation can achieve its objectives. There may be many ways to act and achieve objectives. Manager should know all the alternative ways to achieve the objectives.
4. **Examining/Evaluating alternative courses of action.** All the factors of production can be put to different alternative uses. The planner has to ascertain the possible alternative courses of action. The management has to study effective utility of various factors of production.
5. **Selecting an alternative.** There can be different alternative course of action but every course has its own plus and minus points. A proper evaluation of these points is necessary to determine which of the alternative would be the best of all. Each alternative should be subjected to a close test to determine its suitability. The decision has to be taken in favour of one or the other course of action after testing an evaluation of alternative uses of the factors. The course of action to be adopted should be the best under circumstances.
6. **Implementing the plan.** After the formulation of plan, it is necessary to workout the plan to achieve the objectives. For example, if we have set a plan to assemble 1,000 television sets. To put into action, we have to get raw materials, labour and have to spend money for expenses.
7. **Providing for future evaluation and follow up.** Planning is always with definite purpose. It aims at achieving certain predetermined objectives. In order to ascertain that plans are proceeding along right lines, it is necessary to devise a system of continuous evaluation and appraisal of the plan. In this way, shortcomings can be noted well in time and suitable remedial action may be taken before it is too late. Generally, the controlling part of management compares the actual performance with the planned performance and notices deviations, if any. Corrective actions and remedial measures are adopted to remove deviations. If there is any defect with the plan necessary modifications are made.



Planning Process

Internal Ambitions of ESSAR

The ESSAR group is looking to step-up its global operations by entering the riskier but profitable markets of Africa, Eastern Europe and the middle East.

In its care business of steel, the ESSAR group is also looking at a proposal to acquire an integrated steel plant in Eastern Europe.

The group has also announced its intention of setting-up Greenfield Steel manufacturing operations in Sharjah, Qatar and Iran. It has plans to set upto a 50–50 joint venture with state owned Qatar Steel Company far a 1.5 million tonne steel plant along with a 1 million tonne steel ralling plant on the outskirts of Sharjah and another tonne per annum steel plant in Iran, according to a recent ESSAR newsletter. Even the Indonesia branch of ESSAR, where the group runs a cold-ralling complex is expected to look for meager and acquisitions (M & A) opportunities in the region.

Source: *Business world 25th September, 2006.*

2.7 TYPES OF PLANS

Types of Plans

Standing Plans	Single Use Plans
1. Objectives	1. Programmes
2. Strategy	2. Budgets
3. Policy	
4. Procedure	
5. Methods	
6. Rule	

2.7.1 Standing Plans

Standing plans are those plans which are used over and over again as they focus on organisational situations that occur frequently. Such plans are used to cope with certains strategic objectives rather than being

directed at particular issues or problems. These plans are not limited in time and normally exist during the life-time of the related organisation. Standing plans are aimed at reaching the objective of the management. They ensure that the internal operations of a given business are operating smoothly. For example: Policies, Procedures, Rules etc. The various types of standing plans are explained below.

Objectives

According to **Allen**, *Objectives are goals established to guide the efforts of the company and each of it components.* Objectives are ends towards which the physical and human energies of the enterprise are channelised. Every individual group and departmental efforts are integrated, coordinated and directed to achieve this end. Objectives can be minor, major and collateral.

Objectives, no doubt, are the goal which the enterprise would like to attain, but they are treated as plans because the determination of objectives requires all the steps of planning *i.e.,* collection of information, analysis of facts, evaluation and selection of alternatives.

Characteristics of Objectives

1. **Basis for plans.** Plans are goal oriented. No plan can violate objectives of the business. Every effort has to be directed towards objectives. It is objective, which determines the nature and size of plans.
2. **Plurality of objectives.** Every department may have its own separate objective. There can be different objectives for different activities. According to *Drucker* common objectives of the enterprise may be regarding:
   (*i*) Productivity (*ii*) Goodwill
   (*iii*) Innovation (*iv*) Profitability
   (*v*) Physical and Financial resources
   (*vi*) Healthy employer—employee relations
   (*vii*) Cost reduction (*viii*) Social responsibility
3. **Satisfying main and subsidiary objectives.** The enterprise should specify its main and subsidiary objectives. Profit earning may be the main objective, but in order to earn profit objectives regarding production at minimum cost and sales arrangement etc. may be subsidiary objective.
4. **Long term and short term objectives.** Both long term and short term objectives should be specified. Long term objective may be for 5–6 years, whereas short term objectives are for one year. Short term objectives should be complementary and supplementary to long term objectives.
5. **Constant review of objectives.** Objectives should be constantly reviewed from time to time. This will enable objectives to correspond to the realistic situations of business.
6. **Other characteristics**
   (*a*) Objectives are expressed in quantitative, measurable and concrete terms.

(*b*) Objectives are result-oriented not activity oriented.

(*c*) Objectives should be challenging but achievable.

Examples of Objectives

(*i*) Reduction in quality rejects from existing 5% to 2%.

(*ii*) Appointing 50 efficient management trainees every year from campus interview.

(*iii*) Increasing the sales of a specific product by 5%.

(*iv*) Crossing 30,000 crore mark in sales by 2004.

Strategies

According to **Newman**, *Strategy concern the direction in which human and physical resources will be deployed and applied in order to maximise the chance of achieving a selected objective in the face of difficulties.* Strategy is a military term, which means the art of projecting and planning a military movement and handling troops in the battle field. In the context of business it is the employment of business resources most effectively to achieve specific goal. It is preparing oneself for unforeseen and unpredictable factors. In practice, it is formulated to meet the challenge posed by competitor's policies and actions. Important types of strategy may be 'strike while the iron is hot, camel's head in the tent', 'unity is strength', time is the greatest healer and offence is the best form of defence.

Special Features of Strategies

1. **Strategies are directional plans.** Strategy provides a direction to human and physical resources of the enterprise.
2. **Applicable in exceptional circumstances.** Strategies are applied to meet specific challenges caused by competitor's policies and unpredictable situations.
3. **New deployment of resources.** In order to face specific situations, the resources of the enterprise are put to use in new ways. Modified method, techniques and approaches of applying human and physical resources is the special feature of strategy.
4. **Policies and strategies are different.** Policies are framed to meet general situations, whereas strategies meet specific situations.

Difference between Policy and Strategy

Bases of Difference	*Policy*	*Strategy*
1. *Situation*	Policies are framed to meet general business situations.	Strategies are applied to meet specific challenges.
2. *Period*	Policies are framed for longer periods generally 5–6 years.	Strategies are framed for short term.
3. *Guidance*	Policies guide the managers in taking decision.	Strategies make the new applications of the available resources of the business.

Policies

According to **Dougless**, *Policy is simply a statement of an organisation and intention to act in certain ways, when specified types of circumstances arise.*

Policy is the standing directon to the management to take decisions within the prescribed limit. Every executive has to honour policy and his decisions should not violate it. In this way, we can define policy as *objective oriented continuing decision guides to management in making his decisions in specific similar circumstances.*

Special Features of Policies

1. **Policies are objective oriented.** Policies are framed to achieve the predetermined objectives of the business as such they should be supplementary and complementary to objectives.
2. **Simple and clear.** Policies should be simple and clear, so that employees at different levels should understand it clearly and act accordingly.
3. **Cooperation of managers at different levels.** While formulating the policies cooperation of managers at different concerned levels be sought. Otherwise they may create hurdles in its implementation.
4. **Practicability.** Policies are framed to be adopted and implemented. Thus it should take into consideration the available resources and realistic situations so that it can be put to use.
5. **Policies are continuing decision guides.** It helps the management in making decisions in specific circumstances.
6. **Prescribing decision limits of the management.** Policies decide the boundary limit within which decisions are to be made.
7. **Policies are different from objectives and rules.**

   Examples of Policies

   (*i*) Policy of hiring only universally trained engineers.

   (*ii*) Policy of appointing MBAs only from universities as management trainees.

   (*iii*) Policy of filling-up 75% higher vacant post from the existing employees of the enterprise.

Difference between Objectives and Policies

Both objectives and policies are standing directional plans to be considered by the management, while taking important decisions. They aim at increasing productivity and profitability in an atmosphere of harmonious relationship between workers and management. The important difference between them is as follows:

Bases of Difference	*Objectives*	*Policies*
1. *Aim*	Objectives determine the final goal of the enterprise.	Policies are framed to achieve the objectives efficiently.
2. *What and How?*	Objectives determine what is to be done. In this way, objectives *decide the specific job* to be done	Policies determine how the work is to be done. In this way, policies decide the procedures to be adopted for completion of the job.
3. *Level of Management*	Objectives are determined by owners or top level management.	Policies are determined by the top level, medium level and even lower level management.
4. *Dominance*	Objectives have dominant place in the management as compared to policies.	Policies are objective oriented. They play a supplementary and complementary role in achieving objectives.

Procedures

According to ***Terry***, *A procedure is a series of related task that make up the chronological sequence and the established way of performing the work to be accomplished.* It is the particular way of doing a job. Procedures are series of steps followed in a regular definite order. Procedures are guidelines to actions. They prescribe the exact manner in which the work is to be performed.

Examples: Methods of selecting employees, wage payment, placement of order and handling of cash etc.

Special Features of Procedures

1. **Procedures are methods of doing job.** The work is performed at many stages and it is specified who and how he will accomplish particular work at particular stage.
2. **Procedures are concerned with many departments.** A particular procedure is related to many departments. For example, execution of an order from the customer concerns Sales, Finance, Accounts, Production Cost and Transport Departments.
3. **Pervasiveness of procedures.** Procedures are required for every department and every sort of activities. Procedures are systematic, orderly and detailed arrangement of accomplishing different jobs at different levels right from the decisions of the board of directors to physical work being performed by the ordinary worker.

Methods

Formalised and standardised way of doing routine jobs are known as methods. These are standard ways of doing work. It increases efficiency. There is no penalty for violation of methods.

Examples:

Valuation of stock by LIFO (Last in first out) and FIFO (First in first out) methods.

Difference between Policy and Procedures

Bases of Difference	Policies	Procedures
1. *Necessity*	Policies are required to help in taking decisions.	Procedures are necessary to speed up the performance.
2. *Deviation*	Executives may deviate in their decision on specific job according to their wisdom, understanding and interpretation. Policies and flexible.	There is no possibility of deviation from procedures. They are to be adopted in a similar way by every officer. Procedures are rigid.
3. *Scope*	Policies decide the limits of the activities of the organisation.	It is a plan to execute decisions based on policies.
4. *Levels of Management*	Policies are decided by top level of management.	Procedures are decided by medium and low level executives.
5. *Dependence*	Policies are not dependent on procedures.	Procedures are dependent on policies.
6. *Science and Art*	Policies are systematised and specialised facts as such they are science.	Procedures are concerned with the execution and performance of work and as such it is an art.
7. *Relationship*	There may be different policies for different departments.	Different departments follow the same procedures in all similar activities.

Difference between Rules and Methods

Bases of Difference	Rules	Methods
1. *Objective*	It ensures discipline.	It ensures efficiency of operations.
2. *Basis*	Based on common sense.	Based on research and analysis.
3. *Nature*	Regarded as official and authoritative	Regarded as logical and rational.

Rules

According to **Koontz and O' Donnell,** *"A rule requires that a specific and definite action be taken with respect to a situation"*. Rules are the decisions made by the management regarding what is to be done and what is not to be done in a given situation. Rules do not leave any scope for decision-making. They do not allow any deviations. Examples—'No smoking, No admission without permission' etc. Rules are made for the purpose of creating discipline in the organisation.

Important Rules and Notifications followed in Laxmi Publications (P) Ltd.

1. Smoking is not allowed during duty hours. One can smoke out of office premises during lunch time. ' 500 will be fined for each mistake.
2. Gossiping or talking uselessly during duty hours may cause one or two absents as penalty.
3. Unnecessary/excess stay in canteen during tea time/lunch time is not allowed.
4. Anyone eating or using betel (paan), gutkha or tobacco in the office will be fined ' 500 for the first mistake. If anyone does the same mistake again he will be removed from the service.
5. Outside visitors are not allowed in any floor of the office. Please meet them in the visitor's cabin/reception.
6. Office phone should not be used for personal calls at all.
7. Having or using a mobile phone during office hours is prohibited.
8. This is the duty of the incharge to be attentive to all the above matters. If he/she finds anyone overruling or disobeying any of these rules, he/she should inform the higher authority.

Difference between Policies and Rules

Bases of Difference	*Policies*	*Rules*
1. *Basis*	Policies are based upon objectives.	Rules are based upon procedures.
2. *Flexibility*	While interpreting policy individual offers can deviate in their decisions to some extent according to their understanding.	There is no flexibility. There cannot be any deviation. There cannot be different interpretations.
3. *Situations*	Policies are meant for general situations.	Rules are framed for specific situation or specific job.
4. *Exception*	There can be exception to policies.	There cannot be exception to rules.

2.7.2 Single Use Plans

Single use plans are created to address short-term challenges for short-term initiatives. The scope of these plans is generally smaller than the scope of standing plans. They include budgets and Programmes. Generally such plans are developed for a one-time project or event having one specific goal or objective. The length of single use plan differs greatly depending on the project. It may last one day or a single project may even last weeks or months. Single use plan consists of specific activities to arrive at a specific goals or targets with a determined budget and within a determined or limited time period. The two types of single use plans are explained below.

Difference between Rules and Procedures

Bases of Difference	Rules	Procedures
1. *Decision*	Rules are the decisions taken earlier. These are applied in specific circumstances.	Procedures are not decisions.
2. *Method*	Rules are not the methods of doing a work.	Procedures are the methods of doing work. They tell us, how to perform a specific activity.
3. *Relationship*	Rules do not have any procedures.	Procedures may have their rules.
4. *Exact and Rigid*	Rules are exact and rigid.	Procedures are not so much exact and rigid.
5. *Punishment*	Disobedience of rules is punishable.	Disobedience of procedure is not punishable.

Programmes

Programmes are concrete plans prepared with definite objective to accomplish certain specific activity. Programmes are action always based on to accomplish the given work.

They are combination of various types of plans and they are made to create a systematic working environment in the organisation. Programmes can be classified into two categories (*i*) Primary Programmes (*ii*) Secondary Programmes. The primary programmes are created by top level management whereas the supportive or secondary programmes are prepared at other levels of management for the purpose of providing support to the primary programmes.

Example: Manufacturing 500 television sets in January, 2003, or to introduce a new product in the market etc.

Advantages of Programmes

1. **Appropriate use of resources.** Programmes enable the most effective use of the available resources of the business enterprise.
2. **Efficient distribution of work.** Programmes distribute the work to be done in the most convenient parts and entrust its accomplishment to competent persons.
3. **Better utilisation of time.** Programmes are short-range time based and as such emphasise on the economical use of time.
4. **Coordination of work.** Different departments have different programmes of their own, therefore, while making the programme an effort is made to achieve the maximum integration of different programmes.

Projects

Quite often, the individual portions of a general programme are relatively distinct and planned and executed as projects. A project is a small programme.

Quite often, individual parts of a general programme arc clear-cut and relatively distinct, so they can be planned and executed as separate projects. When the operations of a programme can be easily divided into separate parts with a clear end point, project-structure is preferred. Each project has definite goals concerning task assignments and time. The project itself may consist of several sub-plans. For example, new product development project may be a complex one including sub-plans like developing and exploring new markets for existing products, selling existing products more intensively in present markets, marketing a new product altogether and so an. According to J.M. Stewart, a project has the following features:

- The activity has a clear objective.
- Somewhat unique and unfamiliar to the existing organisation.
- The activity is complex and critical to the organisation.
- The activity is temporary with respect to the duration of need.

One advantage with the project form of organisation is that it allows the project structure to be phased out. The best available talent can be pooled to accomplish a specific and complex activity within time, cost and/or quality parameters.

Budget

The word 'BUDGET' is derived from a French word '*Bougette*', which means a small leather bag. In simple words, the budget is a recorded plan of action expressed in quantitative terms. It is a recorded plan of action expressed in quantitative terms. It is a statement of anticipated results. In this way the *budget is an estimate of future needs, arranged according to an orderly basis, covering some or all the activities of the enterprise for a definite period of time.* In other words, it is a quantitative statement, regarding future needs for certain specific period. It may also be regarding future needs for certain specific period. It may also be regarded as a recorded plan of future estimate regarding sources and their application. In financial terms, it is a periodic statement of future revenue and their expenditure. Budgets are based on forecast and provide direction to business activities. It is rightly said to be the barometer of the business indicating future prospects.

Certain Important Definitions of Budget

"A budget is a standard, with which to measure the actual achievements of people, department etc." **—Wheldon**

"Budgets are finished products—They are formal programmes of future programmes and expected results. Budgets result from forward thinking and planning." **—Harry L. Whyle**

"The budget is a plan of operations integrated and coordinated, comprising all phases of business activities and summarised to show the financial results of carrying out the plan." **—Terry**

In this way, we may define *budget to be a recorded estimate of future business operations during a specific period with reference to their costs and revenue.*

Budgeting is one of the control devices, so any *control affected by the use of Budget may be termed as budgetary control. Budgetary control is planning-controlling mechanism.* The Budget, like planning comes first and the budgetary control like a device of control follows the budget in the cycle of planning-controlling device.

Budgetary control is regarded by certain companies as *profit plans* or *profit paths* because it involves preparation of budgets as planning device and later comparison of actual expenditure or performance with the budgeted or planned performance and at the end taking corrective actions.

Characteristics of Budget

1. **Planning of progress.** Budgets take note of the existing *situations and performance* and plan future activities. The serious consideration is paid to the future uncertainties and seasonal fluctuations. Budgets, no doubt, are the future estimates and aspirations.
2. **Discussing future difficulties.** Future is always uncertain. There are seasonal and cyclical fluctuations. A good budget takes the maximum advantages of business opportunities.
3. **Economical use of resources.** Budgetary control is a device of making the best possible use of resources.
4. **Control over expenditure.** The purpose of making budgets is to make control over expenditure. It keeps check on extravagance and provides for expenditure, wherever it is necessary.
5. **Coordination of operations**. Budgetary control tries its best to integrate and co-ordinate the efforts of physical and human resources towards the achievement of maximum objectives.

Contigency Plan

A plan that's specific and detailed and generally covers a span to one year or less.

2.8 INTRODUCTION & DEFINITIONS OF DECISION-MAKING

Decision-making is an integral part of every manager's job. Decision-making has a wide-range, covering matters from selection of the venue for holding a meeting, to significant issues such as, assignment of resources, hiring and firing of personnel, rate of dividend, merger, etc. In the words of John MacDonald, "The business executive is by profession a decision-maker. Uncertainty is his opponent, overcoming it is his mission. Whether the outcome is a consequence of luck of wisdom, the moment of decision-making

is without doubt the most creative event in the life of the executive."

Decision-making is not the monopoly of top management alone, though it is true that decisions made at this level are of far-reaching importance for the organization as a whole. In fact, managers at all levels are engaged in decision-making of one kind or another, the significance of their decisions differing in proportion to the duties assigned and authority delegated to them.

Definitions

George R. Terry: "Decision-making is the selecting of an alternative, from two or more alternatives, to determine an opinion or a course of action."

Andrew Szilagyi: "Decision-making is a process involving information, choice of alternative actions, implementation, and evaluation that is directed to the achievement of certain stated goals."

Henry Sisk and Cliffton Williams : "A decision is the selection of a course of action from two or more alternatives; the decision-making process is a sequence of steps leading to that selection."

2.9 IMPORTANCE OF DECISION-MAKING

Decision-making is an indispensable component of the management process. It permeates all management and covers every part of an enterprise. In fact whatever a manager does, he does through decision-making only; the end products of manager's work are decisions and actions. For example, a manager has to decide (i) what are the long term objectives of the organization, how to achieve these objectives, what strategies, policies, procedures to be adopted (planning); (ii) how the jobs should be structured, what type of structure, how to match jobs with individuals (organizing); (iii) how to motivate people to peak performance, which leadership style should be used, how to integrate effort and resolve conflicts (leading); (iv) what activities should be controlled, how to control them, (controlling). Thus, decision-making is a central, important part of the process of managing. The importance of decision-making in management is such that H.A. Simon called management as decision-making. It is small wonder that Simon viewed decision-making as if it were synonymous with the term 'managing'. Managers are essentially decision makers only. Almost everything managers do involves decision-making. Decision-making is the substance of a manager's job. In fact, decision-making is a universal requirement for all human beings. Each of us makes decisions every day in our lives. What college to attend, which job to choose, whom to marry, where to invest and so on. Surgeons, for example, make life-and-death decisions, engineers make decisions on constructing projects, gamblers are concerned with taking risky decisions, and computer technologists may be concerned with

highly complex decisions involving crores of rupees. Thus whether right or wrong, individuals as members in different organizations take decisions. Collectively the decisions of these members give 'form and direction to the work an organization does'. Some writers equate decision-making with planning. In fact, Koontz and O'Donnell viewed 'decision-making as the core of planning', implying that is not at the core of organizing or controlling. However, instead of taking extreme positions it would be better to view decision-making as a pervasive function of managers aimed at achieving goals. According to Glueck there are two important reasons for learning about decision-making: (i) Managers spend a great deal of time making decisions. In order to improve managerial skills it is necessary to know how to make effective decisions. (ii) Managers are evaluated on the basis of the number and importance of the decisions made. To be effective, managers should learn the art of making better decisions.

2.10 FACTORS INVOLVED IN DECISION-MAKING

There are two kinds of factors to be considered in decision-making in favor of any alternative. These may be classified as (a) tangible and (b) intangible factors.

Tangible factors

Among the tangible factors relevant to decision-making the important ones are (a) sales; (b) cost; (c) purchases; (d) production; (e) inventory; (f) financial; (g) personnel and (h) logistics.

The effect of any decision on one or more of the tangible factors can be measured and therefore it is easy to consider the pros and cons of every decision. Decisions based on these factors are likely to be more rational and free from bias and feelings of the decision-maker.

Intangible factors

Among the intangible factors which may influence decision-making in favor of any alternative, the important ones are the effects of any particular decision (a) prestige of the enterprise; (b) consumer behavior, (c) employee morale; and so on.

Accurate information and data about these factors is not easy to obtain. Therefore, intuition and value-judgment of the decision-maker will assume a significant role in the choice of a particular alternative.

2.11 TYPES OF DECISIONS

Though managers are constantly called upon to make decisions and all managerial decisions are important in their own ways, some decisions have a limited scope while others involve the entire organization in a significant manner. For better understanding of the managerial decisions, we may classify them as follows:

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1. **Personal and organizational decisions**. This classification was first mooted by Chester Barnard. Accordingly, personal decisions are concerned with the managers as individuals rather than the organizations. As against this, organizational decisions are made by the managers in their official capacities and within the constraints set by their formal authority. Since personal decisions are based on subjective evaluation of the managers, these can neither be delegated nor there any interference or influencing from the top. But organizational decisions may be, and often are delegated to subordinates.

   In order to avoid bias in decision-making, which may be harmful both to the organization and the decision-maker, a clear distinction between personal and organizational decisions has constantly to be maintained, though it is often a difficult task.

2. **Strategic and operational decisions**. Strategic decisions, which are often table for their novelty and complexity and involve uncontrollable factors such as actions of competitors or the state of the economy, are invariably made by the top management. Increasing the rate of dividend, expansion of business, etc., are the examples of strategic decisions.

   Operational decisions are concerned with day-to-day operations of the enterprise. They do not involve much discretion or independent judgment on the part of managers, as the parameters within which the decisions have to be made, are often clearly defined.

3. **Structured and unstructured decisions**. Structured decisions are those which are made within the limits set by the policies, procedures, tradition or custom. They do not require creativity or independent judgment on the part of the manager. As against this, unstructured decisions have neither any existing policies or procedures, nor any tradition or custom as their basis. For this reason, they call for a great deal of imagination and independent judgment, and hence are often within the purview of the top management only.

4. **Crisis and research decisions.** Crisis decisions are those which are made to meet unanticipated situations which do not allow much scope for extensive investigation and analysis of the factors relevant to them. They have to be made instantaneously under pressure of circumstances.

   As against this, research decisions are those which are made after a thorough analysis of pros and cons without any pressure.

5. **Initiative or forced decisions.** Initiative decisions are the hall-mark of aggressive managers who search for or create situations

calling for decision-making by them. Most of such decisions may not be needed in many cases. As against this, forced decisions are those where the managers have no alternative but to make decisions, either under orders from their superiors or due to pressured persuasion by subordinates.

6. **Problem and opportunity decisions.** Problem decisions are concerned with resolving problem situations which have arisen as anticipated, or otherwise. On the other hand, opportunity decisions pertain to taking advantage of an opportunity for increased profits, growth, etc. The frequency of opportunity decisions will depend on how far the manager is prepared to take risks and his skill for recognition of an opportunity.

7. **Programmed Decisions.** Herbert Simon has provided a popular classification scheme for managerial decisions – programmed and non-progammed. A programmed dicision is one that is routine and repetitive, Rule and policies are established well in advance to solve recurring problems quickly. Thus, a hospital establishes a procedure for admitting new patients; a supervisor administers disciplinary actions against workers reporting late for work, a store clerk orders requisition for additional supplies, as soon as the existing stock drops below a specifed level. On the basis of pre-established set of alternatives, programmed decisions can be made in a routine way. Since programmed decisions are relatively easy and simple for managers to make, they allow and equip managers for more challenging and difficult problem-solving. However, routine procedures leavelittle room for the manage to chose. Judgement cannot be used and freedom is affected. Programmed decisions are usually made by lower level personnel on organisations in which the market and technology are relatively stable, and many routine, highly structured problems must be solved. For example, in banks and insurace companies, the market and technology are relatively stable and usually routine problems confront operating personnel. Decisions are highly routinised and the decision-maker simply recognises the problem to implement the predetcemined solution.

8. **Non-programmed decisions.** In such cases. the decision-maker has to make a decision in a poorly structured situation-onein which there no pre-existing, cut-and-dried solutions. Deciding whether to take over a sick unit. how to resttructure an organisation to improve efficiency, which to locate new company warehouse, whom to promote to the vacant position of Regional Manager at one of the comany's plants, are example of non-programmed decisions.

The commonfeature in these decisions is that they are novel and non-recurring and there are no readymade courses of action to resortt to.

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2.12 COMMON DIFFICULTIES IN DECISION-MAKING

Some common difficulties faced in making decisions and implementing them are as follows.

Incomplete information

This is a major problem for every manger. Lack of information leaves a manager adrift in a sea of uncertainty. Not only this, most decisions involve too many complex variables for one person to be able to examine all of them fully.

Un-supporting Environment

The environment - physical and organizational – that prevails in an enterprise affects both the nature of decisions and their implementation. If there is all round goodwill and trust and if the employees are properly motivated, the manager is encouraged to take decisions with confidence. On the other hand, under the opposite circumstances he avoids decision-making.

Non-Acceptance by Subordinates

If subordinates have a stake in the decision or are likely to be strongly affected by it, acceptance will probably be necessary for effective implementation. On the other hand, subordinates may not really care what decision is reached. In such situations, acceptance is not an issue. Democratic leadership style which encourages subordinates to suggest, criticise, make recommendations or decide upon policies or projects is an effective device for gaining their acceptance and commitment.

Ineffective Communication

Another important problem in decision-making is the ineffective communication of a decision. This makes implementation difficult. The manager should, therefore, take care to communicate all decisions to the employees in clear, precise and simple language.

Incorrect Timing

In decision-making, the problem is not merely of taking a correct decision. It is also of selecting an appropriate time for taking the decision. If the decision is correct but the time is inopportune, it will not serve any purpose. For example, if the manager wants to decide about introducing

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a new product in the market, he should take the decision at a correct time. Otherwise, he may lose the market to his competitors.

2.13 GUIDELINES FOR EFFECTIVE DECISION-MAKING

Decision-making is an arduous task. A successful and correct decision is gratifying to the decision maker but he also experiences frustration when he faces ill-structured and uncertain situations and when his decision fails to achieve the decision objectives. Yet, managers must make decisions as it is their most important responsibility to their organization. They cannot afford to display an attitude of "sailing around the world without landing", and "talking about a subject without getting it". The success of an executive depends on his ability to make the right decision at the right time and to pursue its effective implementation. The following guidelines are offered as an aid to effective decision-making.

1. Define the Goals

The decision-maker should define the goals that he seeks to achieve by making a decision. The goal of a decision is derived from his objectives which in turn are a part of the total organizational objectives. Thus, the goal of a decision should be compatible with and contribute to larger goals.

2. Ensure that the Decision Contributes to the Goal

Once the goal has been determined, it becomes the criterion for making the decisions, as well as for evaluating its results. Often, an executive seeks to achieve not one but more than one goals through a decision. For example, the goal of a marketing decision may be not only to increase the sales volume but also increase the profit margin. These goals may not always be compatible. It requires the decision maker to balance the conflicting goals in such a manner that he can achieve all the goals simultaneously.

3. Adopt a Diagnostic Approach

A decision-maker has to be a diagnostician in many ways. He has to identify and define the problem. Further, he has to diagnose what and how much information is relevant to the problem being attacked, and where he will get it. Development and evaluation of alternative also require diagnostic abilities. He also has to diagnose the surrounding situation comprising the internal and external environmental forces. Thus, effectiveness in decision making significantly depends on an executive's diagnostic abilities.

4. Involve Subordinates in Decision-Making Process

Involvement of subordinates in decision-making process serves many purposes. It improves the quality of the decision, particularly if the decision-maker does not possess all the special abilities required for making a particular decision. It is more likely to happen than not, as every decision has several

aspects such as administrators, technical, human relations and financial aspects. The most important stage at which subordinates' participation can enhance the decision quality is the stage of development and evaluation of alternative solutions to problems. Their participation can bring not only new insights to the problem but also elicit their commitment to implement the decision. Those who participate in making a decision tend to become ego involved in it, and thereby committed to its successful implementation.

5. Ensure successful implementation of the Decision

Event he best decision will not yield satisfactory results unless it is implemented effectively. Successful implementation of a decision significantly depends on the extent of understanding of the decision and its implications, and motivation of the subordinates who have to carry it. An executive can enhance his effectiveness in both these directions by promoting upward communication. He should also be able to know when and what kind of guidance is needed by them, and be willing to extend it to those who need it. He can be more effective if he successfully welds his subordinates into a team with himself as the team leader.

6. Evaluate the Results

The purpose of a decision is to accomplish some goal which will not be attained without it. The results of the decision should, therefore, be evaluated in terms of its predetermined goals.

7. Be Flexible

The decision-maker should adopt a flexible approach not only in making the decision but also after the decision has been put into implementation. If it is not yielding the desired results, he should modify, discard, or replace it with another decision which may produce better results.

2.14 DECISION-MAKING—THE QUANTITATIVE WAY

Introduction

The administration of a modern business enterprise has become an enormously complex exercise. There has been an increasing tendency to turn to quantitative techniques and models as a potential means for solving many of the problems that arise in such an enterprise. Management in action is decision-making. We consider decision-making in business to be a process whereby management, when confronted by a problem, selects a specific course of action or solution from a set of possible courses of actions. Since there is generally some uncertainty about the future, we cannot be sure of the consequences of a decision made. The process of making decisions in a business has the same essential characteristics as problem-solving behaviour in general.

Business Decisions

The business manager wants to choose the course of action that is most effective in attaining the goals of the organisation. In judging the effectiveness of different possible decisions, we must use some measuring unit. The most commonly used measure in making decisions is the amount of profit in monetary terms but for our purpose here, we will take only a few of these.

1. Decisions under certainty or uncertainty.
2. Decisions made for one time-period only or a sequence of inter-related decisions over several time-periods.
3. Decisions where the opponent is nature (a family planning, a picnic) or a thinking opponent (setting the price of a product after considering the actions of the competitors).

The following general process of solution is adopted for all types of decision situations:

1. Establish the criteria that will be utilized. One of the criteria may be maximization of profit. In a capital budgeting decision, we choose the project with the highest pay off.
2. Select a set of alternatives for consideration.
3. Determine the model which will be used and the values of the parameter of the process, e.g., we may decide that the algebraic expression of the model of total expenses is:

   Total Expenses = a+ b units sold.

   The parameters are "a" and "b" and their values would have to be determined in order to use the model.
4. Determine that alternative which optimizes or falls in line with the criterion that has been chosen in item 1 above.

Abstraction

Real life problems are very complicated in nature. In empirical situation, there is a large number of inherent "facts," Moreover, every potential course of action triggers off a chain reactions - of course an effect and interaction - and there is no end to this process. Consider the problem of erection of a factory building. Much time is spent on gathering factual information about the project, e.g., the exact location, the physical features of the building ; a minute study of the climatic conditions of the potential sites and their bearing on most of the construction; the raising of finance and the cost of finance raised. By far the most important decision is in respect of the alternative uses to which these funds can be put in the present and future periods. If the manager as a decision-maker prefers to collect all the facts before he acts, it follows that he will never act. It is to be appreciated that it is beyond the comprehension of human mind to consider every aspect and dimension of an empirical problem. Some characteristics of the problem must be ignored if at all a decision is to be made. In other words, it is for the decision-maker to abstract from

the empirical situation those factors which he considers to be the most relevant to the problem he faces. In this way, abstraction initiates the solution of many a human problem.

Model Building

Once the selection of the critical factors or variables has been made by the decision-maker, the next step is to have their combination in a logical manner so as to form a counter-path or model of the empirical situation; ideally, it strips a natural phenomenon of its complexity. It, therefore, duplicates the essential behavior of the natural phenomenon with a few variables, simply related. The more the simplicity of the model, the better it is for the decision-maker, provided the model serves as a reasonably reliable counter-path of the empirical order.

The advantages of a simple model are:

1. It economizes on time as well as on thought.
2. It is within the reach of comprehension and ability of the decision-maker.
3. If occasion arises, the model can be modified quickly and effectively.

The aim of the decision-maker in constructing a model is to approximate reality as far as possible. In other words, a model is a de facto approximation of reality. Replication of reality seems to be a lofty aim and meeting it would consume an infinite length of time. Besides, such an elaborate model would be beyond the reach of human comprehension. Therefore, the manager as a decision-maker wants the simplest possible model that predicts outcomes reasonably well and consistent with effective action on his part.

Solutions

Having constructed the model, it is possible to draw certain conclusions about its behavior by means of a logical analysis. The decision-maker bases his action or solution on these conclusions. The effectiveness of a model depends upon the logical analysis used in drawing conclusions and the abstraction of critical variables from our example. The decision-maker may decide that an interest rate of 12% matches the annual opportunity cost of money for his firm. He can make his decisions on the construction of the factory premises by calculating the present value of the cash flows and would not have to consider the alternative uses of which his funds can be put to in detail.

Errors

Generally, there are two possible types of errors in decision-making to start with. He can err in applying logic to the process of reasoning from premises to conclusions to solutions. The concern may be able to obtain funds at the cost of 12% but management may have decided not to raise any new capital. The premise that one can use the interest rate to represent an opportunity cost is valid, but the conclusion that the use of interest rate applies to all investments is erroneous.

Secondly, there may be a mistake in selecting the variables or the variables selected are not adequate for the construction of the model in our example. The decision-maker has taken into account the time value of money but has ignored the risk element that is associated with the use of money. It is not possible to eliminate errors of this type altogether because it would amount to a consideration of all conceivable pertinent variables and would preclude decisive action. Abstraction does violate reality to some extent but it is a necessary condition for problem-solving. This is one reason why decision-making carries with it the possibility of errors.

Model-Building Techniques

There are several ways of representing the models. Common place repetitive problems as those of eating, walking and opening doors are a matter of thinking in the mind of the decision-maker in an informal and intuitive manner. Such problems are resolved without the aid of a formal model. If the problem is somewhat more complex or unusual, we spend more time on it. It is possible to express to the extent of selecting the important elements of the problem and proceeding to examine and experiment with them. The nature of variables determines the technique of describing and relating selected variables. If the variables are amenable to a quantitative representation, then there are strong reasons for selecting a mathematical representation of the model. Mathematics has a theoretical rigour of its own, and so it ensures a certain orderly procedure on the part of the investigator. It demands specificity in respect of the variables that have been abstracted and the relationships assume to be existing amongst them. For example, it is more difficult to make implicit assumptions in a mathematical model than in a literary model. Secondly, mathematics is a potent tool for relating variables and for deriving logical conclusions from the given premises. Mathematics facilitates the solution of problems of bewildering complexities and also facilitates the decision-making process where quantitative analysis is applicable.

In the recent past, especially since World War II, a host of business problems have been quantified with some degree of success, leading to a general approach which has been designated as operations research. Undoubtedly, the quantitative representation of business problems is much older than operations research, considering the practice of accountancy. However, recently, the use of quantitative techniques has covered all the areas of modern business.

A word of caution is necessary for those businessmen who are found to employ quantitative techniques for business decisions. The conclusion derived from a mathematical model contains some degree of error because of the abstraction process. It is a matter of judgment as to when to modify the conclusion in view of the magnitude of error. Operations research supplements business judgment; it does not supplant it. Moreover, there are many business problems which cannot be given a quantitative representation and so they require the use of qualitative models and solutions. Within the constraints mentioned here, quantitative analysis can become an extremely productive technique for managerial decision-making. Problems

hich would perplex the initiation of the most experienced executives ay, on some occasions, be resolved with relative ease.

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SUMMARY

- **Planning**

  Planning is continuous intellectual process based upon facts to decide, arrange and coordinate the available and prospective human and physical factors in the best possible way to achieve the predetermined desired goals.

- **Nature/Characteristics/Features of Planning**

  (1) Planning is the primary function of management (2) Planning is goal oriented (3) Planning is an intellectual process (4) Planning is pervasive (5) Planning involves decision making (6) Planning is Futuristic (7) Planning does not eliminate future risk but enable us to face it (8) Planning is a continuous process.

- **Importance/Advantages of Planning**

  (1) Planning provides directions (2) Planning reduces the risk of uncertainty (3) Planning reduces overlapping and wasteful activities (4) Planning promotes innovative ideas (5) Planning facilitates decision-making and promotes creativity (6) Helpful in development and expansion (7) Planning establishes standards for control.

- **Limitations of Planning**

  (1) Planning puts managerial activities in a rigid framework and creates false sense of security (2) Planning may not work in a dynamic environment (3) Planning reduces creativity (4) Planning involves huge costs (5) Time consuming device (6) Planning does not guarantee success (7) Machinery of planning can never be free from bias (8) Unsuitability for certain business.

- **Stages/Steps/Process of Planning**

  (1) Setting objectives (2) Developing planning premises (3) Identifying alternative courses of action (4) Examining/Evaluating alternative courses of action (5) Selecting an alternative (6) Implementing the plan (7) Providing for future evaluation and follow-up.

- **Types of Plans**

  Standing plans

  (1) Objectives (2) Strategies (3) Policies (4) Procedures (5) Methods (6) Rules.

  Single use plans

  (1) Programmes (2) Budgets

  Objectives. Goals established to guide the efforts of the company and each of its components are known as objectives.

Strategies. Strategy concerns the direction in which human and physica resources will be developed and applied in order to maximise th chance of achieving a selected objective in the face of difficulties.

Policies. The statement of an organisation and the intention to act i certain ways when specified types of circumstances arise is know as policy.

- **Bases of Difference between Objectives and Policies**

(1) Aim (2) What and how? (3) Level of management (4) Dominance

Procedures. Series of related tasks that make up the chronologica sequence and establish ways of performing the work to be accomplishe are known as procedures.

- **Bases of Difference between Policies and Procedures**

(1) Necessity (2) Deviation (3) Scope (4) Levels of management (5 Dependence (6) Science and Art (7) Relationship.

Methods. Formalised and standardised way of doing routine job i known as method.

Rules. The specific and definite action to be taken with respect to a specified situation are rules.

- **Bases of Difference between Policies and Rules**

(1) Basis (2) Flexibility (3) Situations and (4) Exceptions.

- **Bases of Difference between Rules and Procedures**

(1) Decision (2) Method (3) Relationship (4) Exact and rigid (5 Punishment.

Programmes. Concrete plans with definite objective to accomplish certain specific activity is known as programme.

Budgets. Estimate of future needs arranged according to an orderly basis covering the activities of the enterprise for a definite period of time is known as budget.

- Decision-making is a process involving information, choice of alternative actions, implementation, and evaluation that is directed to the achievement of certain stated goals.
- The effect of any decision on one or more of the tangible factors can be measured and therefore it is easy to consider the pros and cons of every decision. Decisions based on these factors are likely to be more rational and free from bias and feelings of the decision-maker
- Structured decisions are those which are made within the limits set by the policies, procedures, tradition or custom.
- Successful implementation of a decision significantly depends on the extent of understanding of the decision and its implications, and motivation of the subordinates who have to carry it.

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CASE PROBLEMS

An auto company C Ltd., is facing a problem of declining market share due to increased competition from other new and existing players in the market. Its competitors are introducing lower priced models for mass consumers who are price sensitive. For quality conscious consumers, the company is introducing new models with added features and new technological advancements.

Questions

1. Prepare a model business plan for C Ltd., to meet the existing challenge. You need not be very specific about quantitative parameters. You may specify which type of plan you are preparing.
2. Identify the limitations of such plans.
3. How will you seek to remove these limitations?

Case Study

A small business house involved in manufacturing of stationary and paper material is facing a problem of intense competition from the competitors. The competitors are attracting it's workforce by providing higher pay and better facilities hence the staff is not continuing for a longer period and are ready to join the competitors leading to losses for the company. The competitors are in a position to provide better quality products at a very reasonable price which is another major cause of concern.

Prepare a business plan for this company to get rid of the mentioned problem specifying the type of plan or plans needed.

[**Hint.** The company needs to bring changes in its policy and needs to prepare a new strategy].

Case Study

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Questions

1. Prepare a business plan for C Ltd., to melt the existing challenge. You need not to be very specific about quantitative parameters. You may specify which type of plan you are preparing.
2. Identify limitations of such plan.
3. How will you seek to remove these limitations?

REVIEW QUESTIONS

1. Explain, in brief, the meaning of 'Policy' and 'Rules' as types of plans and give any four points of distinction between them.
2. Define '*Planning*'. State any four reasons, why planning is important?
3. Explain '*Policies*' and '*Procedure*' as the types of plans. Differentiate between the two on any four basis.

   Or

   Explain '*Rules*' and '*Methods*' as types of plans. Differentiate between the two on any four basis.
4. Explain how does planning help reducing uncertainties
5. Inspite of best efforts of managers sometimes planning fails to achieve desired results due to its limitations.

   Explain any five limitations of planning.
6. Two years ago Madhu completed her degree in food technology. She worked for sometime in a company Manufacturing chutneys, pickles and Murabbas. She was not happy in the company and decided to have her own organic food processing unit for the same. She set the objectives and the targets and formulation action plan to achieve the same. One of her objective was to earn 10% profit on the amount invested in the first year. It was decided that raw materials like fruits, vegetables, spices etc. will be purchased on these months' credit from farmers cultivating organic crops only. She also decided to follow the steps required for marketing of the products through her own outlets. She appointed Mohan as a production manager who decides the exact manner in which the production activities are to be carried out. Mohan also prepared a statement showing the number of workers that will be required in the factory throughout the year. Madhu informed Mohan about her sales target for different products, areawise for the fourthcoming quarterly. While working on the production table a penalty of ₹ 100 per day for not wearing the caps, gloves and apron was announced.

   Quoting lines from the above para identify and explain the different types of plans discussed.
7. Describe briefly the relationship between planning and controlling.
8. Define 'decision-making'.
9. What is the importance of decision-making?
10. Discuss tangible and intangible factors relevant to decision-making?
11. Write short notes on:
    (a) Factors involved in decision-making.
    (b) Programmed and Non-programmed decision.
    (c) Common difficulties in decision-making.
12. Discuss the guidelines that are offered as an aid to effective decision-making.

UNIT 3 ORGANISING

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★ STRUCTURE ★

3.1 Introduction

3.2 Meaning and Definition of Organising

3.3 Steps in the Process of Organising

3.4 Importance/Purpose of Organising

3.5 Principles of Organisation

3.6 Organising as a Structure

3.7 Types of Organisation Structure

3.8 Formal and Informal Organisation

3.9 Delegation of Authority

3.10 Elements of Delegation

3.11 Importance/Advantages Delegation

3.12 Process of Delegation of Authority

3.13 Centralisation of Authority

3.14 Decentralisation of Authority

3.15 Evaluation of Decentralisation

- Summary
- Review Questions

3.1 INTRODUCTION

Organisation is coordinated efforts of the different individuals working in an enterprise to achieve its goal. Man is a born troublemaker. Every human being is different from others as regards his values, beliefs, intellect, likes and dislikes, as such there are conflicts of interests and preferences. No enterprise can allow the individuals working in it to behave and work in their own way, because it will not only upset the work but may uproot even the enterprise. As such, the employees have to be motivated, guided and if necessary forced to cooperate and coordinate their activities for the accomplishment of the organisational objectives. **Chaude S. George, Jr.** rightly says about organisation. It integrates the various jobs of the enterprise into an effective organisation system for accomplishing the firms's objectives.

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In this way, the manager combines and co-ordinates individual as well as group activities to achieve the goal of the business in an efficient and effective manner through organisation.

3.2 MEANING AND DEFINITION OF ORGANISING

The term 'organisation' is derived from the work *'organizm'*, which means a structure of body divided into parts. The different parts of human body performing different activities combine themselves into sound body structure. In the same way, organisation in an enterprise means the integration and coordination of individual efforts to achieve the cherished goal of the business enterprise.

Before defining organisation, it will be proper to consider the following elements of organisation:

(*i*) Organisation is a group activity.

(*ii*) Organisation consists of—Assigning duties, granting authority, fixing responsibility and coordinating activities.

(*iii*) Organisation is the means to achieve the objectives of the enterprise.

It shows that organisation is used in the following two forms in the business.

(*a*) Organisation as a structure. (*b*) Organisation as a process.

3.3 STEPS IN THE PROCESS OF ORGANISING

Organising means identifying, arranging and integrating different elements of organisation into efficient working order. It requires the management to follow the following process of organising

"Organising is the establishing of effective authority relationships among selected work, persons and work places in order for the group to work efficiently." **—G.R. Terry**

"In its broad sense organising refers to relationship between various factors present in a giving endeavour or enterprise." **—William Spriegal**

"To organise a business is to provide it with everything useful to its functioning raw materials, machines and tools, capital and personnel."
"Organisation is the process of identifying and grouping the work to be performed, defining and delegating responsibility and authority relationships for the purpose of enabling people to work most effectively together in accomplishing objectives." **—Lous. A. Allen**

1. **Identification and division of work.** The main function is divided into sub-functions and entrusted to the different departmental heads. The result is the establishment of departments like Purchase, Sales, Production, Accounts, Publicity and Public relations. The departments can be further classified just as production department

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into (*i*) Planning, (*ii*) Designing, (*iii*) Operations, (*iv*) Production control and (*v*) Repairs and Maintenance. The division of the work is based upon the fact that specialisation is keynote of efficient organisation.

2. **Grouping job and departmentation.** The second step is to group similar or related jobs into larger units, called departments, divisions or sections. Grouping process is called departmentation.

   The department may be based upon functions such as manufacturing, marketing and financing etc. Departments may also be based on products, such as textiles, cosmetic, stationery etc. These departments may have different sections as per requirement.

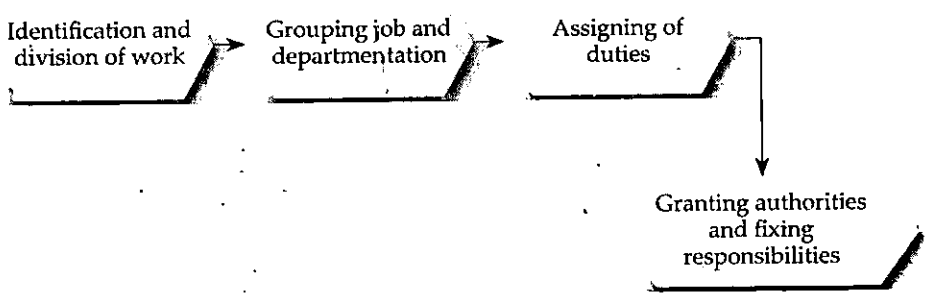
   Grouping jobs or departmentation aims at achieving coordination and facilitates unity of efforts. The departments are linked together on the basis of interdependence. The divided task is assigned to specific individual or group of individuals who are supposed to be the most qualified and specialised persons for the task.

3. **Assigning of duties.** The work to be performed by every individual is clearly defined and made known to him. Everyone must know, what he is required to do in order to avoid any misunderstanding, duplication or overlapping in the work.

4. **Granting authorities and fixing responsibilities.** Assigning of duties to individuals must coincide with the appropriate and relevant authorities. Every employee must know, what are the authorities granted to him and for what and to whom he will be responsible, liable and accountable.

   The establishment of such clear relationship helps to create a hierarchical structure and helps in coordination amongst various departments.

Process of Organising



3.4 IMPORTANCE/PURPOSE OF ORGANISING

Effective organisation is the means to achieve the objectives of the enterprise. It is the basic function of management. Organisation makes the proper arrangements of the requisite resources and make its most useful and efficient application. It provides right direction to the efforts of

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individuals and groups. The organisation structure results in the proper balanced, coordinated and controlled development of the enterprise. It is the only means to achieve the maximum objective of the business at minimum sacrifice and wastages.

No doubt, organisation is an important tool to achieve the objectives of the enterprise, which can be proved by the following facts:

1. **Benefits of division of work and specialisation.** Organisation makes clear division of work. Every job is assigned to the right person. The duty, authority and responsibility of every employee is predetermined which enables easy control of business affairs. The scientific analysis and classification of job results in specialisation and its related advantages.
2. **Clarity in working relationship.** A good organisation structure honours the principle of the unity of command which specifies that every employee has to receive orders from the one specific person and he is responsible for his work given to him only. This enables proper execution of work and at the same time eliminates confusion, duplication and misunderstanding. The principle of unity of direction makes provision of the equal authority and responsibility at all uniform levels, so the employees feel that they are not subject to injustice and inequality.
3. **Optimum utilisation of resources.** Organising enables the enterprise to make optimum utilisation of physical and human resources. An effective organisation reduces the wastages of physical and human resources and makes their most economical use resulting in reduction of the cost of production.
4. **Adaption to change.** Elasticity in the organisation helps in the requisite changes in the organisation structure and also in the introduction of new plans and appointment of technocrats.
5. **Development of personnel.** The training facilities enable the employees to make the optimum use of business resources economically, otherwise the employees would have adopted 'trial and errors method' and caused a lot of wastage of resources.
6. **Effective administration.** An effective organisation integrates and coordinates the efforts of individuals and departments. The coordination results in the achievement of the maximum business objectives at minimum sacrifice. Thus, it brings effectiveness in administration.
7. **Expansion and growth.** Organisation helps in the growth and diversification of an enterprise by enabling it to deviate from existing rules and regulation and taking up new challenges.

K.C. Towe rightly says, *A sound organisation is the answer to every business problem, that a poor organisation could run a good product into the ground and that a good organisation with a poor product could run a good product out of the market.*

3.5 PRINCIPLES OF ORGANISATION

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The important principles of organisation, as listed by Koontz, may be stated as:

1. ***Purpose of Organising:*** Organisation should facilitate the achievement of enterprise objectives in an efficient way.
   (a) *Principle of 'unity of objective:* An organisation structure is effective when it helps in the achievement of enterprise objectives.
   (b) *Principle of organisational efficiency:* An organisation structure is efficient if it facilitates the achievement of objectives with minimum costs. An efficient organisation structure operates without wastage of resources, allows maximum utilisation of human resources, offers clear lines of authority and responsibility and provides a means for personal development.
2. ***The Cause of Organising:*** Span of management is the basic cause of an organisation structure. But for the principle of span of management, firms would ever remain small-managed by only one manager.
   (a) *Principle of spun of management:* A manager should have a limited number of subordinates reporting to him direct. Generally, the span should be short for novel, complex work and long for routine, simple work.
3. ***The Structure of Organisation (Authority):*** Authority is the cementing force in every organisation. It is the means by which groups of activities can be put under a manager. It enables the top management to coordinate enterprise work effectively. A manager can show proper direction and create an environment for sound individual performance.
   (a) *Principle of scalar chain:* A scalar chain or chain of command refers to the unbroken line of authority from the top level to the bottom of an organisation. A dour chain of command facilitates communication.
   (b) *Principle of authority and responsibility:* Adequate authority must be given to managers at the lower level. The superior must state clearly what he expects, when he expects it done and by whom; The subordinate, on his part, must show good performance, following the directives of the superior. Responsibility, in simple terms, is the obligation of a subordinate to perform die duty as required by the superior. As a matter of principle, there should be parity between authority and responsibility. Authority without corresponding responsibility results in misuse of authority while responsibility in the absence of adequate authority brings about frustration and ineffective performance. More importantly, it should be noted here that, responsibility is final and it cannot be re-delegated. By delegating work to

lower levels, the superior is not relieved of his responsibility in any way. He is still responsible for the final result.

(c) *Principle of unity of command:* The unity of command principle states that for any given activity an employee should be made accountable to only one superior.

(d) *Authority level principle:* Decisions within the authority of individuals should be made by them and not referred upward in the organisation structure. Delegation would be a futile exercise if the subordinates wait at the doorsteps of a superior for an audience before they take actions within their authority.

4. ***The Structure of Organisation (Departmentation):*** The primary purpose of organising is to provide a basic structure in the form of a departmental framework.

   (a) *Principle of functional definitions: The* duties, authority and responsibility of every individual must be clearly stated. People at various levels must know what they are supposed to do, when, and for whom. They must also know the limits to their behaviour.

5. ***The process of Organising: The*** process of organising becomes easy when the following principles arc applied sincerely:

   (a) *Principle of balance:* Different departments and activities in an organisation should be given, balanced and proportionate emphasis in relation to their overall contribution to objectives.

   (b) *Principle of flexibility: The* organisation structure should be designed in a flexible way. It should be possible to effect changes in the structure depending on situational requirements.

   (c) *Principle of stability:* At the same time, the organisation structure should be reasonably stable. Stability refers to the organisations ability to withstand changes so as to meet stated organisational goals in an efficient manner.

   (d) *Principle of simplicity:* The structure should be simple so that personnel follow the assignment of work and allocation of duties and responsibilities. The facilitates leadership activity also.

3.6 ORGANISING AS A STRUCTURE

Organisation as structure means *organisation as structure of relationship between formal positions and jobs.* It is a *classical or static concept,* because it establishes relationship between various positions in the enterprise instead of maintaining cordial relationship between persons occupying the position. According to this view organisation as structure means coordinated relationship. The view is not accepted by modern thinkers, because it ignores informal relationship between individuals.

Some of the important definitions of organisation by those who consider organisation as a structure:

Organisation as Structure

"Organisation is a harmonious adjustment of specialised parts for the accomplishment of some common purpose or purposes." **—Haney**

"Organisation is the establishing of effective behavioural relationship among selected work, persons, and work places in order, for the group to work together effectively." **—Terry**

"Organisation is the structural frame work within which the various efforts are coordinated and related to each other." **—Theo Haimann**

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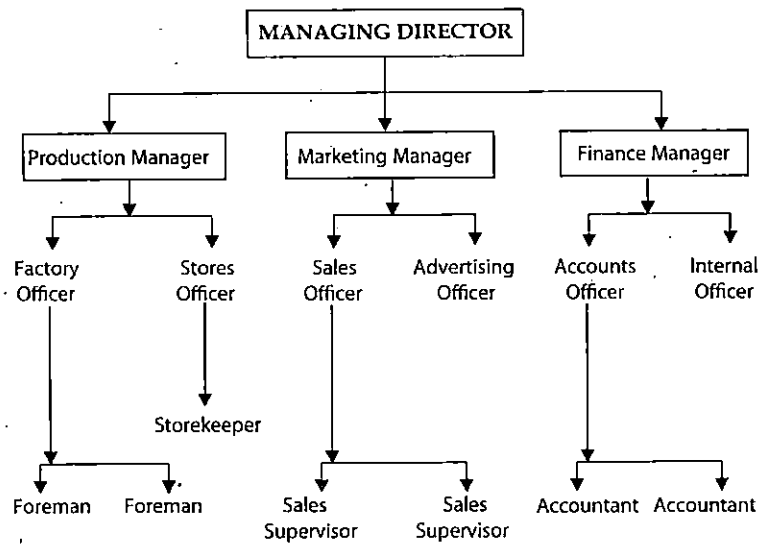
ORGANISATION STRUCTURE



3.6.1 Special Features of Organisation as Structure

Organisation as structure of relationship has the following important features:

1. **Relationship between members of groups.** Organisation as a structure is the formal relationship among positions and jobs of the enterprise to a greater extent. It also stresses close relationship between individuals of group, whether large or small.
2. **Means to attain desired objectives.** Organisation is a tool to achieve the predetermined goal of the business. It is the means to attain the common objective.
3. **Cooperation between members.** In order to achieve the common goal of the business individual efforts are coordinated and integrated.
4. **Formal relationship.** Formal structure of the organisation is governed by the established rules and regulations. The authority and responsibility of various positions is clearly defined.
5. **Communication.** The persons occupying positions have communication links among themselves and share their views as and when required.

Considerations in Designing an Organisation Structure

(*i*) **Design of the job:** The jobs in the organisation should be appropriately designed so that the activities which have to be

performed in different jobs are clear and definite. After the job has been designed it becomes easier for the manager to assign task to various subordinates and to six responsibility for them. The structure of the organisation is generally based upon the nature and design of the job.

(*ii*) **Departmentation:** The jobs designed can be classified into various functions such as marketing, finance, production etc. classifying and grouping of jobs results in creation of departments within the organisation. All the related jobs are put under one department and the functioning of the organisation becomes smoother.

(*iii*) Span of management: It refers to the number of subordinates a manager can take care of. The number of subordinates under a manager should be to that extent to which he can carry out his responsibilities effectively and efficiently. The number of persons under a manager depends upon the following factors:

(*a*) Nature of work.

(*b*) Degree of control and supervision required.

(*c*) Degree of coordination needed.

(*d*) Capability of the manager.

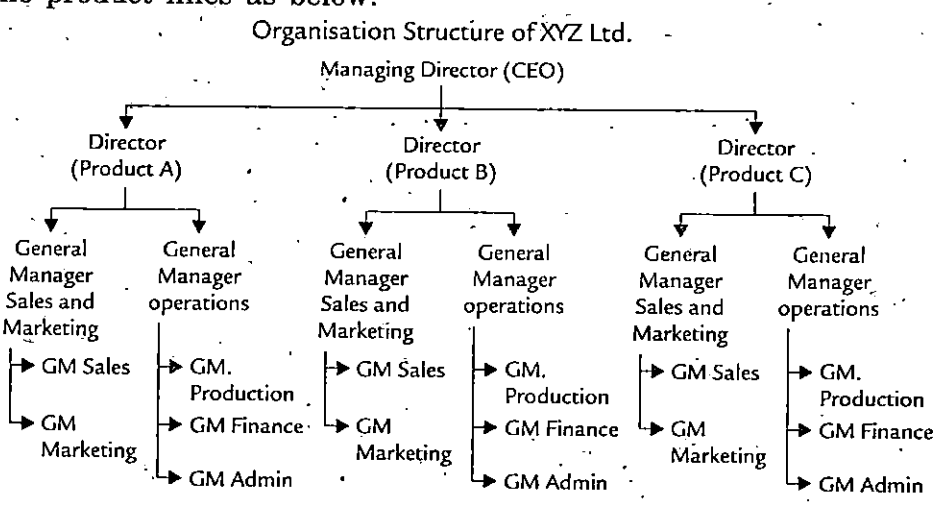
(*e*) Efficiency of the subordinates.

(*f*) Similarity of functions.

(*iv*) **Authority–Responsibility relationship:** (Delegation) If responsibility is assigned to a particular subordinate, he should be provided with sufficient authority so that he can perform his duties effectively and efficiently. Thus responsibility should be accompanied by sufficient amount of authority. It leads to sharing of authority in the organisation which helps in deciding the structure of various positions from top level to the lower level.

Case Study

XYZ Ltd., is a machine tool manufacturing company. The company has three products A, B and C. The current organisation structure is based on the product lines as below:



Recently, the company ran into trouble and its sales started declining and cost started increasing resulting in lower margin for the business. After careful analysis, the following issues were identified for bad business performance over the last 3 to 4 years.

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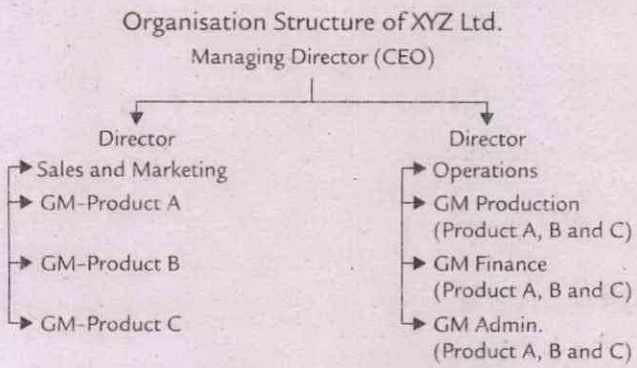
1. Each product director is looking into his/her domain without much interaction with other product directors.
2. Product A, B and C have good market but product directors do not help each other to increase sales. For example, product A is sold to one customer but product B and C are not referred to the same customer who is using other brands of the same product.
3. There is no integration between production/finance/admin. departments of product A, B and C to learn from each other to contain cost.

Question

Q.1. You need to comment on the current organisation structure and suggest another organisation structure with reason.

Ans. The current organisation structure lacks the business integration model as the directors of each product only work for their product segment. Also, there is no coordination pertaining to production/ finance/admin. departments of the organisation. I would suggest the following organisation structure.



The above organisation structure will help in the following way:

1. Control will be established on both sales and cost part for all three products A, B and C.
2. The objective of director–sales and marketing is to maximise sales of all three products and bring synergy in the sales team effort.
3. The objective of director operations is to minimise cost by integrating the production, finance and admin. departments of products A, B and C. This will help in utilising available resources in the best possible way.
4. The proposed structure mentioned above is much leaves and goal oriented in terms of maximising sales and minimising cost. The above case study provides a glimpse of divisional and functional organisational structure and their application in actual business scenario.

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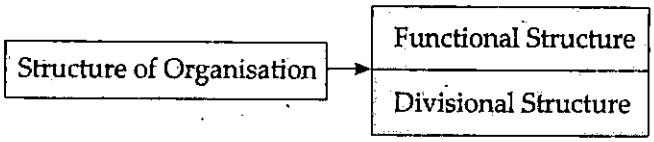
3.7 TYPES OF ORGANISATION STRUCTURE

In order to achieve the desired goals, sound and effective organisational structure is necessary. The organisational structure can be classified under two categories which are as follows:



3.7.1 Functional Structure of Organisation

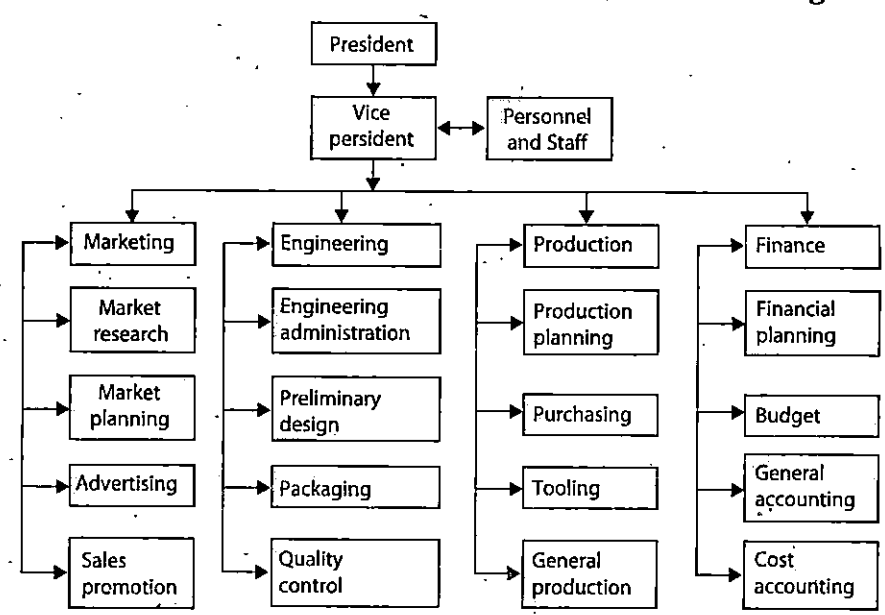
Grouping together the entire work into major functional departments and entrusting these departments to functional specialists is known as functional structure of organisation. Each major function of the enterprise is organised as a separate department. These departments may be Engineering, Production, Personnel, Finance and Marketing in a manufacturing company. If it is a retail store, these departments may be purchase, sales and stores etc., as per requirement. The names of the departments can change as per the requirements, nature and size of the enterprise.

Major functions of the enterprise differ from each other on account of technicalities involved, specialised education and training needed. However, these functions have common goal of achieving maximum efficiency to maximise overall returns of the enterprise. The functional heads are provided functional authority over the subordinates under their command.

Functional organisation is the developed form of Taylor's functional foremanship. In practice, modern functional organisation is restricted to top level of the organisation structure and not carried down to the lowest level as recommended by Taylor.

Functional structure of organisation is extensively used these days by almost every enterprise at different levels. The sales, production, finance and marketing functions are so widely recognised that almost every enterprise uses it as the basis of departmentation.

FUNCTIONAL ORGANISATION STRUCTURE (Manufacturing Company)



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Advantages of Functional Structure

1. **It is a logical reflection of functions.** It differentiates functions in such a manner that each function is organised on a logical pattern for its performance. This helps in integrating the diverse organisational activities towards achievement of common goal.
2. **It maintains power and prestige of major functions.** Major functions like production, marketing, finance etc., are assigned to departmental head to drive major activities concerning these functions.
3. **It follows principle of occupational specialisation.** Each function is separated and taken special attention in overall organisational set-up. This facilitates division of labour and specialisation for each function. Each department is managed by a specialist.
4. **It simplifies training.** Due to success of specialisation, it becomes easy to train new entrants. Simplified training methods are used to reduce learning curve of new employees.
5. **It furnishes means of tight control at top.** Each functional head is responsible for the performance of his function. Budget is allocated to these functional heads on the basis of which their performance is measured.
6. **Convenient supervision.** The manager becomes acquainted with the activities under his command. It facilitates supervision.

Disadvantages of Functional Structure

1. **De-emphasis of overall company objectives.** Due to separation of each function from each other, overall organisational objectives suffers. Each functional head emphasis on the performance of his function and lacks emphasis on the overall objectives of the company.
2. **Overspecialises and narrow viewpoint of key personnel.** Personnel concentrate on their own functions without caring about its impact on the overall organisation. This narrows their viewpoint and they miss the broader view of organisational achievement.
3. **Responsibility for profits is at the top only.** Responsibility for profits lies with the president or CEO while each functional head looks after his assigned area of activity. This makes it difficult to integrate diverse functions towards achievement of common objectives.
4. **Slow adaptation to changes in environment.** Due to lack of inter-functional interaction personnel tend to become less responsible to any change. Their style of functioning does not remain as dynamic as the external and internal environmental changes taking place in the organisation.
5. **Limits development of general managers.** General managers act as mere supervisor rather than learning in depth the organisational activities. Each functional head reports to general manager, who has little interference in the performance of that function. This limits the development of general managers.

Suitability of Functional Structure

Functional structure is suitable in the following situations:

(*i*) Where enterprise is large sized with high degree of specialisation.

(*ii*) Where workload on managers is uneven.

(*iii*) Where authority is decentralised.

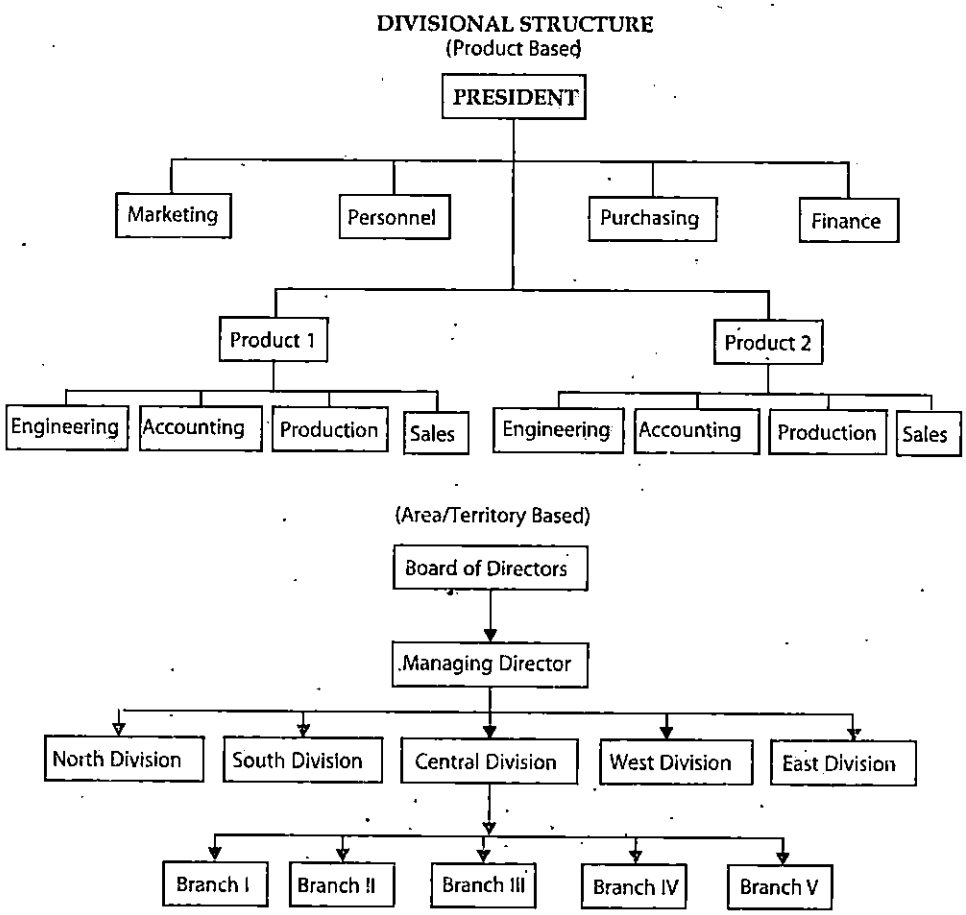
(*iv*) Where specialist services are required and activities are diversified.

3.7.2 Divisional Structure of Organisations

Grouping of activities or departmentation on the basis of product, product lines and areas is known as divisional structure of organisation. Divisional structure has been finding favour with the multiple large scale enterprises. Under this structure the top level delegates extensive authorities to the divisional heads. The divisional head is the incharge of the manufacturing, purchase, sales, engineering and other departments of the division under his command. He is also made responsible for the profit or loss of his division.

Product based Divisional Structure

Product and product line is an important basis for departmentation. It facilitates the use of specialised and specialist services of the divisional managers in their product line. He can use his personal skill and his specialised knowledge for the development of his department.



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Advantages of Divisional Structure

1. **Places attention and effort on product line.** It facilitates attention on individual product line so that highest efficiency in terms of production and sales can be achieved in that product line.
2. **Facilitates use of specialised capital, skills and knowledge.** The resources are used for a single product line to bring specialisation in its performance. Allocation of resources is made between different product lines.
3. **Permits growth and diversity of products and services.** Attention on individual product line permits its growth and facilitates diversification of enterprise.
4. **Improves coordination of functional activities.** Activities like sale, marketing, production are better coordinated due to their clear-cut attention on different product lines. Overlapping of functional activities is avoided.
5. **Places responsibility for profits at the divisional level.** Responsibility can be fixed according to product lines. Each responsibility centre has to take care of its performance in terms of profitability.
6. **Furnishes measurable training ground for general managers.** Separation of responsibility according to product lines facilitates smooth and specialised training for managers. It helps in achieving maximum benefit out of their efforts.

Disadvantages of Divisional Structure

1. **Requires more persons with general manager abilities.** It requires more managerial resources especially in enterprises, where single product lines are not vast enough to need separate managerial resource.
2. **Tends to make maintenance to economical central services difficult.** Centralized services like lighting, furnishing etc. become difficult to maintain due to their distribution amongst separate product lines. If they are used in a centralized manner, it would have been more economical.
3. **Overlapping of functions.** Top management has to monitor each product line separately which makes it difficult to analyse the overlapping of the functions.
4. **Excessive expenditure.** Separate departments with separate entire set of activities become the victim of excessive expenditure. Multiplication of the same efforts and selfish attitude of the department adds to the cost of operation.
5. **Duplication of efforts.** Generally certain set of activities are found in every departments. Repetition of these activities results in the duplication and multiplication of efforts and expenditure.

6. **Self-centred.** Every division tries to maximise its own profit, sometimes at the cost of other divisions. The divisions become selfish and self-centred. Consequently overall performance of the enterprise suffers. Lack of coordination and mutual distrust disturbs the smooth functioning of the enterprise.

Suitability of Divisional Structure

Divisional structure is suitable in the following situations:

(*i*) When an organisation is involved in the production of different line of products.

(*ii*) Organisations needing product specialisation.

(*iii*) Business houses which plan to produce more line of products in future.

(*iv*) Organisations having various divisions and each division require separate departments such as production, sales finance etc.

Difference between Functional and Divisional Structure

Bases of Difference	*Functional Structure*	*Divisional Structure*
1. *Meaning*	Every major function has separate department.	Every major product or area has separate divisions.
2. *Utility*	It is useful for all types of enterprises.	It is useful for diversified organisations.
3. *Nature of Specialisation*	Its specialisation is based upon occupations having functional departments.	It is product or territory based specialisation having separate divisions and sub-divisions.
4. *Cost of the Structure*	It is economical as compared to Divisional Structure.	It is expensive as compared to Functional Structure.
5. *Coordination and Control*	Coordination between departments is difficult but control of the departments is simple.	Coordination between divisions is simple but control of divisions is difficult.
6. *Responsibility for Performance*	Responsibility of poor or excellent performance is joint.	Every division is responsible for its poor or excellent performance.
7. *Autonomy*	Its departments have lesser autonomy.	Its divisions have more autonomy.

3.8 FORMAL AND INFORMAL ORGANISATION

Organisation builds harmonious relationship between individuals. It integrates the individual efforts and leads to the achievement of common objectives of the enterprise. Relationship between individuals in the organisation can be classified into formal and informal organisation.

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3.8.1 Formal Organisation

The formal organisation is legally, deliberately and rationally constituted by defining the duties, authorities and responsibilities of employees individually and collectively. The mutual relationship between different individuals and groups is determined as per rules, regulations and policies of the enterprise. According to **J.A.C. Brown** "formal organisation refers to structure of well defined jobs each bearing a definite measure of authority, responsibility and accountability."

Characteristics of Formal Organisation

(*i*) This organisation is *predetermined and deliberately* constituted.

(*ii*) The organisation is *based upon scientific analysis* and serious considerations.

(*iii*) The relationship is determined *according to the jobs* and its nature.

(*iv*) The organisation is *based upon the jobs to be performed* not according to the individuals whom it has been entrusted.

(*v*) Organisation structure is *determined by the top level.*

(*vi*) The relationship established by formal organisation has *to be honoured.*

(*vii*) The organisation does *not take into consideration emotional aspect.*

Advantages of Formal Organisation

(*i*) *Fixing of responsibilities* in case of failures.

(*ii*) *Clear determination of duties*, authorities and responsibilities.

(*iii*) *Reasonable and balanced division* and sub-division of the activities.

(*iv*) *Easy and effective co-ordination* and control over activities.

(*v*) *Stability in the organisation through rules and regulation.*

(*vi*) *Ensures optimum utilisation of the available resources.*

In this way, formal organisation is a planned organisation structure describing the set pattern of authority and responsibility. It is a power structure to achieve corporate goals.

Limitations of Formal Organisation

(*i*) *Delay in action* as in a formal organisation chain of command is followed which increases the time taken for decision making.

(*ii*) Formal organisation *does not give importance to social needs* of employees which demotivates them.

(*iii*) A formal organisation *does not understand human relationship*, it emphasises more on structure and work.

(*iv*) *If reduces creativity as employees are bound to follow the policies and rules.*

3.8.2 Informal Organisation

Informal organisation is a psycho-social system developed due to inter-personal and social relationship. It arises spontaneously on the basis of friendship and common interest, which may or may not be work related. This organisation is formed informally between worker, employees, travellers, pilgrims, players and friends etc. According to Keith Davis "Informal organisation refers to the relationship between the people in the organisation based on personal attitudes, prejudices, likes, dislikes etc."

Informal organisation arise because man by nature is a social animal.

Characteristics of Informal Organisation

(*i*) Informal *relationship is established spontaneously.*

(*ii*) The relation is based upon friendship and *common interest.*

(*iii*) It is a *voluntary* organisation.

(*iv*) The relationship is based upon *social, emotional* and *psychological needs.*

(*v*) The relationship is based upon *personal preferences* and understanding.

(*vi*) It is *not pre-planned* and not even determined officially.

(*vii*) It *reflects human relationship.*

(*viii*) Management does not create informal organisation and cannot abolish it.

In this way, it is *voluntary and independent organisation, developed automatically and spontaneously between individuals to satisfy their social and human needs.*

Role/Importance/Advantages of Informal Organisation (Relationship with Formal Organisation)

(*i*) Informal organisation *influences the attitudes* of human element in the enterprise towards the work and enterprise.

(*ii*) *Satisfies human desire of co-existence,* fellow-feeling and brotherhood.

(*iii*) It *provides social status* and sense of social security.

(*iv*) It removes the weaknesses of formal organisation. Thus, it is *complementary to formal organisation.*

(*v*) It is an *effective means of communication.* It is a grapevine communication and spreads where formal organisation fails to do.

(*vi*) It keeps a *check on the authoritative behaviour* of managers.

Informal organisation may sometimes be dangerous to the management, because it may spread rumours against the management, its policies and intentions, but management cannot stop it, just as it cannot form it. The best course for the management will be to utilise the informal organisation in the best interest of the enterprise.

Limitations of Informal Organisation

(*i*) Most of the information passed through informal structure are rumours which can mislead the employees.

(*ii*) Informal organisation does not have a systematic working structure for smooth running of the business.

(*iii*) It is very difficult to implement change if the informal organisation opposes them.

(*iv*) Informal organisation emphasises more on individual interests and satisfaction rather than organisational interests.

(*v*) Informal organisation may lead to situation and circumstances which are against the interest of the organisation. It may resist changes in the organisation which can adversly affect the growth of the enterprise.

Difference between Formal and Informal Organisation

Both formal and informal organisations co-exist in an enterprise. Though formal organisation is formed but informal organisation emerges itself spontaneously. In order to keep the enterprise working, both formal and informal organisations are necessary as the two blades of a scissors.

Bases of Difference	***Functional Organisation***	***Informal Organisation***
1. *Formation*	It is the result of company's rules, policies regulations and is deliberately planned.	It is the result of working together, and social interactions.
2. *Predetermined purpose*	It achieves predetermined purpose and planned goals.	It has no predetermined purpose. It achieves social satisfaction.
3. *Stability*	It is well thought, and predetermined so enjoys stability.	It is spontaneously and automatically developed, so, it has no stability.
4. *Relationship / Behaviour*	The relationship between boss and subordinates and even employees is clearly ascertained. Behaviours are directed and governed by the rules and procedures laid down by the management.	There is no specific and clear relationship. Behaviours are spontaneous over-flow of heart and governed by the personal beliefs, values and attitudes.
5. *Structure*	It is official organisation, consciously constructed.	It is sentimental organisation, automatically developed.
6. *Examples*	Formal groups exist in every organisation. Committees, project, teams, small sections or cells and task forces are its examples.	Its examples are the relationship between travellers, passengers, players and pilgrims. It develops on the basis of common interest.
7. *Flow of authority*	Authority flows vertically.	Flow of authority in horizontal.

8. *Effective Co-ordination*	Organisation is planned to result in balanced and effective co-ordination between individuals and their efforts.	There is no planned relationship as such the question of integration and coordination between individuals and their efforts does not arise.
9. *Emphasis*	It emphasises jobs and functions of enterprise.	It emphasises emotions of members.
10. *Cherished goal*	It intends to achieve organisational goals.	It provides social satisfaction to people.
11. *Adherence to rules*	Rules are written and rigidly followed.	There are no set rules. It is a grapevine.
12. *Communication*	Communications have to pass through prescribed channels.	There is no prescribed channel of communication. It is informal.
13. *Leadership*	Appointed managers are leaders.	Leaders are voluntarity chosen.

3.9 DELEGATION OF AUTHORITY

Large scale and complex nature is the notable features of modern business. Management has to perform various, varied and diverse activities, which he cannot do all alone. It is, therefore necessary that the management must share its work with others, so that the task assigned must be performed. In this way, the process of sharing task with its corresponding authority with the subordinates is known as delegation of authority.

Interview with Azim Premji

Knowledge.wharton.upenn.edu: April 20, 2006

Azim Premji, owns more than 80 per cent of Bangalore-based Wipro, India's third largest software exporter, which had annual revenues of US$ 1.8 billion in 2005. Forbes magazine reckons that his net worth exceeds US$ 13 billion, and it places him at No. 25 in its most recent ranking of the world's richest people Premji speaks with Ravi Aron, a professor of operations and information management at Wharton, about Wipro's reorganisation.

Definition of Delegation of Authority

"Delegation of authority merely means the granting of authority to subordinates to operate within prescribed limits." **—Haimen**

"Delegation means assigning work to others and giving them authority to do it." **—Moore**

"Delegation means in brief the passing on to other of a share in the four elements of the management process." **—E.F.L. Brech**

"Delegation is in a way an elementary art of managing." **—Koontz and O' Donnell**

3.10 ELEMENTS OF DELEGATION

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3.10.1 Authority

Authority is the power to command employees and instruct them to do a piece of work. The authority enables the employee to know certain facts, to enjoy a privileged position and to command respect and obedience from subordinates.

Authority in the opinion of management experts:

In the words of **F.W. Moore,** "*Authority is the right to decide and the power to act and carry out decisions.*"

In the opinion of **Koontz and O' Donnell,** "*Authority is legal or rightful power, a right to command or to act.*"

According to **Henri Fayol**, "*Authority is the right to give order and the power to exact obedience.*"

According to **Davis Filley**, "*Authority consists principally of the rights to decide and command.*"

G.R. Terry, defines, "*Authority as the power to exact others to take actions considered appropriate for the achievement of predetermined objective.*"

Special Features of Authority

(*i*) It is the *legitimate right to command* and control subordinates.

(*ii*) Authority has *social, legal and biological limits.*

(*iii*) Authority is granted to *achieve the cherished goal* of the enterprise.

(*iv*) Authority is exercised *through persuasion and sanctions.*

(*v*) Authority is the *right to direct* others to get things done.

(*vi*) Authority is also a *commanding force* binding different individuals.

(*vii*) Authority is delegated downward.

It is now obvious, that the term authority is used in various ways in management literature, depending upon the perspective of authority. However we shall define, Authority is as the right of the managers to guide, lead and direct the efforts of the subordinates to achieve organisational goals.

It is a right to decide, command and exact obedience from subordinates.

Difference between Authority and Power

(*i*) Authority is the right to influence others, whereas power is the capacity to influence.

(*ii*) Delegation of authority is possible and usually done but power cannot be delegated.

(*iii*) Power is the personal capacity, while authority is linked to official status.

Authority is classified as formal, technical and acceptance. Formal is an official authority delegated through chain of command. Technical authority

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emerges from specialised knowledge and skill. Acceptance authority is the results of obedience due to faith or fear.

3.10.2 Responsibility

It is closely related to authority and power. Responsibility is the obligation to do something. In organisation, responsibility is the duty that one has to perform in organisational tasks; functions or assignments. A manager can delegate his authority but responsibility cannot be delegated.

Responsibility as defined by Management Authorities

"Responsibility is the obligation of the individual to perform assigned duties to the best of his abilities under the direction of his executive."

—Davis

"Responsibility may be defined as the obligation of a subordinate to whom a duty has been assigned to perform." **—Koontz and O' Donnell**

"Responsibility is the obligation to carry out assigned activities to the best of his abilities." **—George R. Terry**

Special Features of Responsibility

(*i*) Responsibility is *assigning duty* to human beings only.

(*ii*) Responsibility *always flows upward* from juniors to seniors.

(*iii*) Responsibility is the *result of duty assigned.*

(*iv*) Responsibility is the *obligation to complete* the job as per instruction.

(*v*) Responsibility *can never be delegated.* It is *personal obligation*, and *absolute also*. The manager remains responsible to his superiors for the job even after its delegation.

Responsibility is therefore an obligation to perform the assigned task to the best of one's worth.

Delegation is aimed at reducing the workload of executives, so that they may make the best possible use of their time and energies in solving important matters, thus the manager cannot delegate all of his work. If it is done, there will be no necessity of the executive himself.

Jobs-which can be Delegated

(*i*) Works of routine nature.

(*ii*) Works, which do not require specialised competence.

(*iii*) Jobs, which are not confidential.

(*iv*) Jobs, which are to be performed by subordinates in the interest of organisation.

(*v*) The performance of job will increase the knowledge, competence and experience.

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Following Functions should Not be Delegated

(*i*) All confidential works.

(*ii*) Functions of planning, organisation, direction and controlling.

(*iii*) Disciplinary work.

3.10.3 Accountability

It means holding an individual answerable for final results. The subordinate is held accountable to superiors. The subordinate has to give explanations, before his superiors for the failure in case of accountability. Accountability arises from responsibility.

The important principle of accountability is the principle of *single accountability, which means accountability refers to individuals not groups.*

Special Features of Accountability

(*i*) Accountability *can neither be shared nor delegated.*

(*ii*) Accountability is a *legal responsibility.*

(*iii*) Accountability is *unitary.*

(*iv*) Accountability *relates to assigned duties.*

(*v*) Accountability is always from *downward to upward.*

(*vi*) Accountability is *different from responsibility.*

Responsibility relates to the work to be done, whereas accountability is the obligation to do the work satisfactorily.

Comparison of Authority, Responsibility and Accountability

Bases	*Authority*	*Responsibility*	*Accountability*
1. *Meaning*	It is legal right to command and extract work from others.	It is an obligation to perform the assigned task.	It refers to the answerability for the outcome.
2. *Origin*	Authority originates from laws, rules and regulations.	Mutual relation of superiors with their subordinate leads to origin of responsibility.	It originates from responsibility or duties assigned.
3. *Delegation*	Authority can be delegated.	Responsibility cannot be delegated.	Since it is absolute it cannot be delegated.
4. *Flow or direction*	Authority always flows downward.	Responsibility always flows upward.	It flows in an upward direction.
5. *Nature*	Authority is power	Responsibility is duty or obligation.	Accountability is answerability.

Relationship between Authority and Responsibility

Authority and responsibility go together. They are intimately related. If management is supposed to be cycle, authority and responsibility are

its two wheels. In order to achieve the desired goal of the enterprise, authority and responsibility must flow together.

Special Features of Delegation of Authority

(*i*) *Obtained authorities* only can be delegated.

(*ii*) The officer who delegates the authority *remains liable* even after the delegation of authority to subordinates.

(*iii*) Authorities granted as per delegation *can be withdrawn.*

(*iv*) Authorities regarding *ordinary* and *routine works* only can be delegated.

(*v*) There should be *control of the officer* over subordinates in case of delegation.

(*vi*) The subordinates work *according to* order and instructions of the original officers.

(*vii*) Authority, responsibility and duty are clearly specified.

In this way, *Delegation of authority is an art of granting certain ordinary, routine and exact authorities to competent subordinates, so that they can perform the work as per instruction efficiently.*

3.11 IMPORTANCE/ADVANTAGES OF DELEGATION

Delegation of authority is an essential tool for effective organisation. Every executive has to perform wider range of activities. His scope of authority is wide enough but his capacity to work and supervise is limited, so it is always in the interest of the organisation that the routine, ordinary and general work should be delegated to competent subordinates. This will result in the effective accomplishment of work on the one hand and on the other hand, it will increase efficiency of the executive. The manager will be in a position to get a major part of work done by competent subordinates, and he will multiply himself as regards the quantity of work done on his behalf by delegatees. We can now summarise the advantages of delegation of authority:

1. **Effective management.** Delegation enables the executives' jobs to be performed by the subordinates, which no doubt, multiplies executive services. He is spared from routine affairs and attends to important complicated matters.
2. **Facilitating employee development.** The subordinate performs the work of the executive as per delegation and becomes competent and capable of replacing him in case of absence and retirement of the manager. He performs his piece of work intelligently in case of his promotion.
3. **Facilitation of growth.** The delegatee learns the executive's job and becomes capable of doing it, which increases his ability, understanding and competency and thus results in professional growth.

4. **Helping the expansion of business.** If the enterprise expands, well-trained, experienced and competent persons are readily available to take up the positions. These persons are also habituated of working in the real situations of the business.
5. **Motivation of employees.** The subordinate performs the work of executive as per delegation and thereby their morale and self-confidence is increased. He works with zeal, and improves his efficiency to get promotion.
6. **Better coordination.** Delegation enables managers and subordinates to establish close relationship with each other. It improves the atmosphere and maintains effective co-ordination at all levels of management.
7. **Achieving business goals.** Delegation is made in such a way, that it integrates and channelises the efforts and energies of individuals to the desired goal of the business and facilitates in achieving it.

3.12 PROCESS OF DELEGATION OF AUTHORITY

Delegation is the systematic process of sharing routine duty and the corresponding authority with the subordinates.

The process of delegation has the following three important elements:

1. Assigning duty or task or responsibility 2. Granting authority 3. Creation of obligation or accountability.

1. **Assigning duty or task or responsibility.** Responsibility refers to the task assigned to a person, positions or job. Responsibility involves all those mental and physical activities which need to be performed to carry out a certain duty.

The expansion of business makes it very difficult for the management to perform all the work entrusted to him effectively, therefore, he shifts a part of his routine duty to competent subordinates. The delegated piece of work should be complete in itself, so that the delegatee may not escape from the responsibility. All the details regarding the work delegated and the result expected should be clearly defined and explained to the delegatee.

The delegatee should be *under control* of and *in contact* with the original officer for effective accomplishment of the work. The assigned duties must be *ordinary, general, routine* and less important from organisational point of view. The original officer should himself perform the important, secret and complicated work.

The person who delegates duty is himself responsible for its successful accomplishment to his superior, therefore, he should get the work done under his guidance and supervision.

2. **Granting authority.** The authority regarding the assigned duty should also be delegated otherwise the work cannot be done efficiently. Authority according to Allen is the sum total of the power and rights entrusted to make possible the performance of work delegated.

According to **Koontz and O' Donnell,** *Actually the authority vested in a managerial position is the right to use discretion, the right to create and maintain an environment for the performance of individual working together in a group.* There are the following three types of authorities:

(*i*) Authority of knowledge (*ii*) Authority of position (*iii*) Legal authority.

Authority in this way, is the power to incur expenses, purchase essential articles, appoint employees, order workers to do certain work and to carry out orders. An authority, wherein the subordinate employees cannot be compelled to do a piece of work is useless. It means that the requisite and relevant authority in accordance with the duty assigned must be delegated, whether it is authority of knowledge or position.

3. **Creation of obligation or accountability.** Accountability means holding an individual answerable for final results. The subordinate is held accountable to superior. Accountability originates, because the manager has a right to require an accounting for the authority delegated and task assigned to a subordinate.

Accountability, according to **Allen** *is the obligation to carry out responsibility and exercise authority in terms of performance standard established.*

Dalton E. McFarland has put it as *Accountability refers to the fact that each person who is given authority must recognise that the executive above him will judge the quality of his performance.*

The delegatee is accountable to superior for the piece of work delegated to him. Likewise the superior will also be accountable before his superior for the entire work even if a part of it was delegated by his subordinate. It means *delegation is the art of getting work done effectively, not escaping from accountability to superiors. Accountability on the part of delegatee means giving explanation of work delegated to him to his superior.*

3.13 CENTRALISATION OF AUTHORITY

Retention or concentration of authority at top level for decision-making with one or few managers is known as centralisation of authority. In case, all the decisions are retained with the top management, the organisation is said to be highly centralised. As such, there is little delegation of authority in case of highly centralised organisation. Every command and instruction flows from owners of the enterprise.

For example, a private company consisting of three members Mr. Ansar, Mrs. Ansar and their son has purchase officer, sales marketing and finance officers as employees. The departmental heads are not independent in taking decisions. The decision is taken by the proprietors. Every decision,

command and instructions originate from the owners. It is the example of highly centralised enterprise. Strict discipline, control, better performance, quick response and no initiative is the feature of this organisation.

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3.14 DECENTRALISATION OF AUTHORITY

Decentralisation of authority means the dispersal of decision-making authority to lower levels. In case of decentralisation important authorities regarding planning, organising, directing and controlling is retained at top level and other functions are delegated at lower level.

Decentralisation is the result of effective delegation of authorities. Decentralisation transfers authorities to subordinates and thus the authority instead of being centralised in few hands in spread over a number of employees. Decentralisation is this way, is the division of business functions into certain units and entrusting each unit to different persons with overall authority and responsibility.

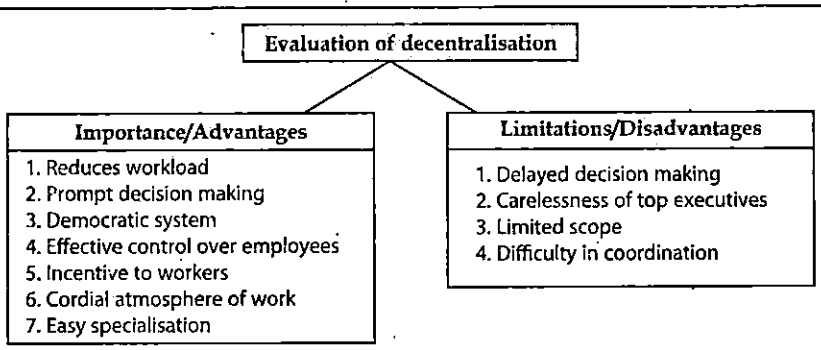
Decentralisation as Defined by Management Experts

According to **Koontz and O' Donnell,** *"Decentralisation of authority is a functional phase of delegation to the extent that authority is not delegated, it is centralised."*

In the words of **Allen, L.A.,** *"Decentralisation refers to systematic effort to delegate to the lowest level of authority except the one which can be exercised at Central Points."*

In the opinion of **Henri Fayol**, *"Every thing that goes to increase the importance of the subordinate's role is decentralisation."*

3.15 EVALUATION OF DECENTRALISATION



Importance/Advantages of Decentralisation

1. **Reduces workload.** Decentralisation is the technique of distributing authority, responsibility and duty among managers, so the workload of the manager is reduced and restricted to the job assigned to him.
2. **Prompt decision-making.** Managers are free to make their own decision promptly within the specific area of task assigned to them. The enterprise enjoys the benefit of quick decision-making.

3. **Democratic system.** Decentralisation shares authority and responsibility between managers. It avoids concentration of power, which is a democratic approach towards management.
4. **Effective control over employees.** Decentralisation provides managers at lower level adequate authority to take their own decisions regarding production schedule and disciplinary action against shirkers. Efficient supervision leads to effective control.
5. **Incentive to workers.** Decentralisation boosts the morale of employees. It provides them job satisfaction by providing them independence, status and participation in the activities of the enterprise.
6. **Cordial atmosphere of work.** There is cordial atmosphere of work due to harmonious relationship between employees caused by job satisfaction. Morally-boosted employees enjoy sense of pleasure in performing their job.
7. **Easy specialisation.** Under decentralisation, authority in all departments and at all levels are dispersed systematically and assigned to the experts of the departments. It enables the emergence of specialisation easily. The enterprise avails of the economies of specialisation.

Limitations/Disadvantages of Decentralisation

1. **Delayed decision-making.** Decision making at different levels by different managers delays the process of decision making whereas in case of centralisation decisions are taken collectively and quickly for all departments. It is also due to the lack of coordination due to large number of decision making authorities.
2. **Carelessness of top executives.** Decentralisation makes top executives careless in performing their duty. They rely too much on their juniors, which is sometime injurious to the enterprise.
3. **Limited scope.** Decentralisation cannot be made in all sorts of work *i.e.*, Planning and Accounting etc. Decentralisation in all organisations and at all levels is not useful. Complete decentralisation is not possible.
4. **Difficulty in coordination.** Decentralisation is responsible for the emergence of large number of decision making managers. It is very difficult to maintain coordination among them.

3.15.1 Difference between Delegation and Decentralisation

Delegation and Decentralisation, both concern with the transfer of authorities to low level employees but even then they differ from each other. In case of delegation full responsibility and accountability is not transferred to delegatee, whereas decentralisation transfers full authorities, rights and accountability to the subordinates. Delegation is the result of interpersonal

relations and understanding between the executive and subordinate and decentralisation is the result of organisational policies.

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Difference between Delegation and Decentralisation of Authority

Bases of Difference	*Delegation of Authority*	*Decentralisation of Authority*
1. *Compulsion*	There is delegation in every organisation at every level. Delegation is more or less compulsory in the enterprise.	Decentralisation may not be in the organisation. It is the top level management, which decides introduction of decentralisation in the organisation.
2. *Control*	There is more control of top level executive over the medium and bottom level executive.	There is lesser control over low level executive. Decentralisation is not a
3. *Process*	Delegation of authority is a process.	process, it is result of the policy of the organisation.
4. *Relationship*	Delegation is interpersonal relationship between manager and his subordinates.	Decentralisation is related process, it is result of the organisation.
5. *Coverage*	Delegation is restricted to different executive and their subordinates.	Decentralisation covers entire organisation. The authority is spread and entrusted to executive according to their level.
6. *Responsibility and Accountability*	Full responsibility and accountability is not transferred. The executive remains liable to his superior even after delegation of authority.	Full responsibility and accountability is transferred. The executives holding authority are held liable.
7. *Purpose*	The purpose of delegation is the multiplication of the manager. It means that large amount of work can be performed with the delegation of authority.	The purpose of the decentralisation is to increase subordinates' role in the organisation and achieve the objective of the business.
8. *Parties Involved*	Delegation involves two Parties, the officer delegating the authority and the subordinate whom authority is delegated.	It involves the entire organisation. It is concerned with all managerial levels.
9. *Withdrawal of Authority*	Delegation of authority can be withdrawn by the officer, who had delegated the authority. It is the individual officer's sweet will to continue or withdraw the authority.	Decentralisation of authority of cannot be withdrawn easily. These authorities can be withdrawn when decision to discontinue the policy of decentralisation is takes.

SUMMARY

- **Organising**

  Organising means the integration and coordination of individual efforts to achieve the desired objectives of the business.

- **Steps in the Process of Organising**

  (1) Identification and division of work (2) Grouping job and departmentation (3) Assigning of duties (4) Granting authorities and fixing responsibilities.

- **Importance/Purpose of Organising**

  (1) Benefits of division of work and specialisation (2) Clarity in working relationship (3) Optimum utilisation of resources (4) Adaption to change (5) Development of personnel (6) Effective administration (7) Expansion and growth.

- **Organising as a Structure**

  Special features of organisation structure.

  (1) Relationship between members of groups (2) Means to attain desired objectives (3) Co-operation between members (4) Formal relationship (5) Communication.

- **Types of Organisation Structure**

  1. Functional structure of organisation.

  2. Divisional structure of organisation.

  Functional Structure of Organisation

  Grouping together the entire work into major functional departments and entrusting these departments to functional specialists is known as funtional structure.

  Advantages of Functional Structure

  (1) Logical reflection of functions (2) Maintaining power and prestige of major function (3) Following principle of occupational specialisation (4) Simplifies training (5) Furnishes means of tight control at top (6) Convenient supervision.

  Disadvantages of Functional Structure

  (1) De-emphasis of overall company objectives (2) Overspecialises and narrows viewpoint of key personnel (3) Responsibility for profits is at the top only (4) Slow adaptation to changes in environment (5) Limits development of general managers.

  Suitability of Functional Structure

  (1) For larger sized enterprise (2) For high degree specialisation (3) For uneven workload on managers (4) Where authority is decentralised (5) Where specialist services are required and activities are diversified.

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Divisional Structure of Organisation

Grouping of activities or departmentation on the basis of product, product lines and area is known as Divisional structure.

Advantages of Divisional Structure

(1) Places attention and effort on product line (2) Facilitates use of specialised capital, skills and knowledge (3) Permits growth and diversity of products and services (4) Improves coordination of functional activities (5) Places responsibility for profits at the divisional level (6) Furnishes measurable training ground for general managers.

Disadvantages of Divisional Structure

(1) Requires more persons with general manager abilities (2) Tends to make maintenance to economical central services difficult (3) Overlapping of functions (4) Excessive expendi-ture (5) Duplication of efforts (6) Self-centred.

Difference between Functional and Divisional Structure

Bases of difference (1) Meaning (2) Utility (3) Nature of specialisation (4) Cost of the structure (5) Coordination and control (6) Responsibility for performance (7) Autonomy.

- **Formal Organisation**

It is deliberately and scientifically designed and legally constituted by defining authorities and responsibilities of employees individually and collectively.

Characteristics of Formal Organisation

(1) Predetermined and deliberately constituted

(2) Based upon scientific analysis (3) Relationship is determined according to job (4) Based upon jobs to be performed (5) Structure determined by top level (6) Honouring relationship (7) Emotional aspect not taken into consideration.

Advantages of Formal Organisation

(1) Fixing of responsibilities (2) Clear determination of duties (3) Reasonable and balanced division of activities (4) Easy and effective coordination (5) Stability in the organisation through rules and regulation (6) Ensures optimum utilisation of the available resources.

Limitation of Formal Organisation

(1) Delay in action (2) Does not give importance to social needs (3) Does not understand human relationship. (4) If reduces creativity as employees are bound to follow the policies and rules.

- **Informal Organisation**

It is psychosocial system of organisation developed due to inter-personal and social relationship.

Characteristics of Informal Organisation

(1) Spontaneous relationship (2) Relationship based upon common

interest (3) Voluntary organisation (4) Meets emotional needs (5) Based upon personal preferences and understanding (6) Not pre-planned (7) Reflects human relationship (8) Management cannot abolish.

Advantages of Informal Organisation

(1) Influences human attitude (2) Satisfies human desire of co-existance (3) Provides social status (4) Complementary to formal organisation (5) Effective means of communication (6) Check on authoritative behaviour of managers.

Limitations of Informal Organisation

(1) Information passed through informal structure are rumours (2) Does not have systemic working structure (3) Does not implement changes (4) Emphasises more on individual interests and satisfaction (5) Informed organisation may lead to situation and circumstances which are against the interest of the organisation.

Bases of difference between Formal and Informal Organisation

(1) Formation (2) Predetermined purpose (3) Stability (4) Relationship/ behaviour (5) Structure (6) Examples (7) Flow of authority (8) Effective coordination (9) Emphasis (10) Cherished goal (11) Adherence to Rules (12) Communication and (13) Leadership.

- **Delegation of Authority**

The process of sharing task with its corresponding authorities, with the subordinates is known as Delegation of authority.

- **Elements of Delegation**

Authority

It is the right to command, decide, direct, take actions and exact obedience from subordinates. The authority enables the employees to enjoy privileged position, to command respect and obedience from subordinates.

Responsibility

Responsibility is the obligation to do something. It is the duty, which has to be performed as per assignments. It always flows upward. It is personal obligation and absolute also, so it can never be delegated.

Accountability

Accountability means holding an individual answerable to final results. Accountability refers to individuals not groups. Accountability can neither be shared nor delegated.

Special Features of Delegation

(1) Delegation of obtained authorities (2) Executive remaining liable even after delegation (3) Delegated authorities can be withdrawn

(4) Delegation of routine authorities only (5) Control of officer over subordinate (6) Work according to order and instructions. (7) Clear specification of authority, responsibility and duty.

- **Bases of difference between Authority and Responsibility**

(1) Meaning (2) Origin (3) Delegation (4) Flow or Direction (5) Period (6) Nature.

- **Importance/Advantages of Delegation**

(1) Effective management (2) Facilitating employee development (3) Facilitation of growth (4) Helping the expansion of business (5) Motivation of employees (6) Better coordination and (7) Achieving business goals.

- **Process of Delegation of Authority**

(1) Assigning duty or task or responsibility (2) Granting authority (3) Creation of obligation or accountability.

- **Centralisation of Authority**

Concentration of authority regarding decision-making with an individual or few managers is known as centralisation of authority.

- **Decentralisation of Authority**

It is dispersal of decision-making authority to lower levels. It divides business functions into certain units and entrusting the different units to certain persons with appropriate authority and responsibility.

- **Evaluation of Decentralisation**

Importance/Advantages of Decentralisation

(1) Reduces workload (2) Prompt decision-making (3) Democratic system (4) Effective control over employees (5) Incentive to workers (6) Cordial atmosphere of work (7) Easy specialisation.

- **Limitations/Disadvantages of Decentralisation**

(1) Delayed decisionmaking (2) Carelessness of top executives (3) Limited scope (4) Difficulty in coordination.

- **Bases of Difference between Delegation and Decentralisation**

(1) Compulsion (2) Control (3) Process (4) Relationship (5) Coverage (6) Responsibility and Accountability (7) Purpose (8) Parties involved and (9) Withdrawal of authority.

REVIEW QUESTIONS

1. What is meant by 'divisional structure' of an organisation ? Explain any two of its advantages and two limitations.
2. Explain the steps involved in the process of organisation.
3. Briefly explain the considerations that need to be kept in mind while designing the organisational structure of a company.
4. What is meant by 'Functional Organisational Structure'? State any two advantages and two disadvantages of such structures.

Or

Describe the steps involved in the process of 'organising'.

5. Explain the organisational structure. Distinguish between Functional and Divisional structure on the following bases:

   (*i*) Formation (*ii*) Managerial development (*iii*) Responsibility (*iv*) Suitability.

6. Discuss briefly the principles of parity of authority and responsibility and 'unity of command'.

7. The concept of centralisation and decentralisation are related to the concept of delegation. Explain.

8. A manager is of the view that he is not responsible for the quality of work that he has delegated to subordinate. Do you agree with this viewpoint? Justify your answer by giving appropriate answer.

   [We do not agree because of 'the principle of absoluteness of responsibility.']

9. Define the terms *'Responsibility' 'Authority'* and *'Accountability'*.

10. Explain, in brief, any six points which highlight the importance of decentralisation in an organisation.

11. Differentiate between functional and divisional structure of organisation an any six basis.

12. The functional structure of organisation has certain advantages and disadvantages which an enterprise must take into consideration before adopting it. Explain any such three advantages and any three disadvantages of this structure.

13. Decentralisation is an important philosophy that implies selective dispersal of authority. In the sight of this statement, explain any four points of importance of decentralisation.

14. Put simply, decentralisation refers to delegation of authority throughout all the levels of the organisation. In the light of the above statement give the meaning of and difference between delegation of authority and decentralisation.

15. Aman Chadha started 'Bulls Eye' a company for providing cyber security solutions to businesses. Its objective is to prevent, detect and respond to cyber attacks and protect critical data. He was a hardworking software engineer and an expert in cyber security. His reputation grew by leaps and bounds as he was not only a person of integrity but also did his work with utmost honesty and sincerity.

    The business started growing day by day.

    He was delighted when he was offered a big project by the Ministry of Defence. While working on the project, he found that the volume of work made it impractical for him to handle all the work by himself. He decided to expand the team. The company maintained a close liaison with a local engineering college. During a campus placement, Ishan and Vrinda were appointed to work for the new project.

He found the new employees capable, enthusiastic and trustworthy. aman Chadha was thus, able to focus on objectives and with the help of Ishan and Vrinda, The project was completed on time. Not only this Aman Chadha was also able to extend his area of operations. On the other hand Ishan and Vrinda also got opportunities to develop and exercise initiative.

(*i*) Identify the briefly explain the concept used by Aman Chadha in the above case which helped him in focusing on objectives.

(*ii*) Also, state any four points of importance of the concept identified in (*i*) above.

16. Explain any four differences between delegation and decentralisation specifying the basis of difference.

17. Voltage fluctuations have been common and quite high in India. They harm our electrical appliances like televisions, refrigerators and air conditioners, often leaving them in a permanently damaged conditions. N-Guard company decided to manufacture stabilizers for North India where the voltage fluctuation ranges from 220 V to 230 V. Once the demand for North India was taken care of, they decided to launch stabilizers in other regions of India also. Three engineers were appointed for South, West and East regions of India, as the voltage was different in all the three regions.

Though all the engineers were appointed to manufacture stabilizers but the product differed from region to region.

(*a*) Identify the organisational structure of N-Guard company.

(*b*) State any two advantages and two limitations of the structure identified in the above para.

CASE PROBLEMS

1. A company, which manufactures a popular brand of toys, has been enjoying good market reputation. It has a functional organisational structure with separate departments for Production, Marketing, Finance, Human Resources and Research and Development.

   Lately to use its brand name and also to cash on to new business opportunities it is thinking to diversify into manufacture of new range of electronic toys for which a new market is emerging.

2. A company X limited manufacturing cosmetics, which has enjoyed a pre-eminent position in business, has grown in size. Its business was very good till 1991. But after that, new liberalised environment has seen entry of many MNC's in the sector.

   With the result the market share of X limited has declined. The company had followed a very centralised business model with Directors and divisional heads making even minor decisions. Before 1991 this business model had served the company very

well as consumers had no choice. But now the company is under pressure to reform.

3. XYZ Ltd., decided to start a business of manufacturing bags. They identified various activities which they have to perform like

   (*a*) purchase of raw material

   (*b*) purchase of machinery

   (*c*) production of bags

   (*d*) arrangement of finance

   (*e*) sale of bags

   (*f*) selection of employees.

   In order to look after production finance, marketing and personnel managers were appointed.

1. Identify the function of management involved in the above mentioned para.
2. State the steps involved in the process of this function of management.

UNIT 4 OWNERSHIP

NOTES

★ STRUCTURE ★

4.1 Basic Forms of Business Ownership

4.2 Sole Proprietorship

4.3 Joint Hindu Family Business

4.4 Partnership

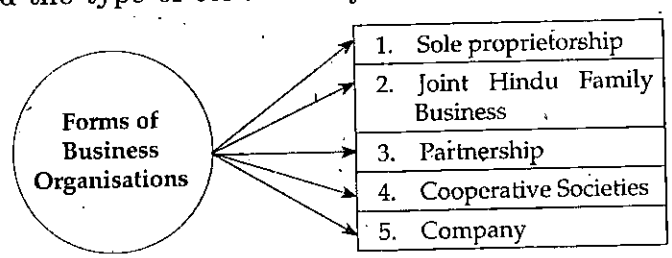
4.5 Cooperative Societies

4.6 Company

- Summary
- Review Questions

4.1 BASIC FORMS OF BUSINESS OWNERSHIP

Business organisations have different forms which depend on the choice of the entrepreneur or the promoter of the business. This chapter will help students to learn the structure of various forms of business. If they want to start a business in future they will be able to decide which form of business is best suitable to them depending on the level of resources available and the type of control they want to exercise on the business.



4.2 SOLE PROPRIETORSHIP

Sole proprietorship is the form of business, which is owned, managed and controlled by an individual. It is the oldest and simplest form of business, established with the limited resources, ability and capital. The business, if it is legal can be started anywhere, anytime at the sweet will of the individual. As such, sole proprietorship is the form of business organisation in which an individual introduces his own capital, uses his own skill in managing the affairs of the business and is solely responsible for the result of the business operations.

The law does not make any distinction between the firm and the proprietor. The business and the businessman are one and the same

thing. In other words, owner's personal property is also liable for business liabilities. If the business earns profit, the sole proprietor enjoys all the profit alone and if the business suffers loss, it has to be borne by the sole trader himself.

In the words of **Peterson and Plowman,** *"A sole proprietorship has no legal existence apart from the proprietor himself. He is the firm".* It means that he has unlimited liability and even his personal property is always at stake for the payment of business debts and loans.

According to **J.L. Hansen,** *"sole trader is a type of business unit where a person is solely responsible for providing capital, for bearing the risk of the enterprise and for the management of business".*

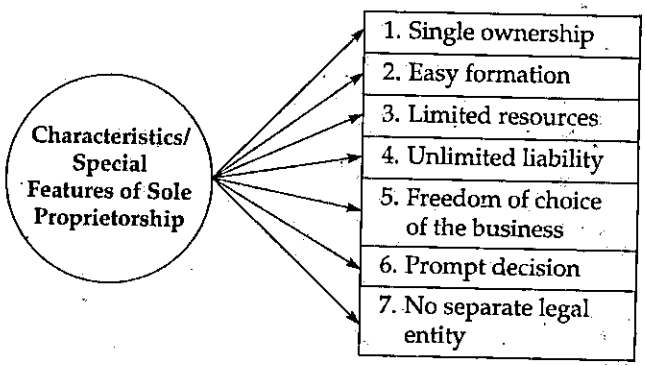
In the word of **L.H. Haney,** *"the individual proprietorship is the form of business organisation at the head of which an individual as one who is responsible, who directs its operations and who along runs the risk of failure".*

According to Kimball and Kimball, A sole proprietor is the supreme judge of all matters pertaining to his business subject only to general laws of land and to such legislation as may affect his particular line of business.

Sole proprietorship is also called *sole trade, single ownership, single proprietorship, individual ownership and proprietorship, one man business etc.* It has got the following important features.

4.2.1 Characteristics/Special Features of Sole Proprietorship

The sole proprietorship has got the following characteristics:



1. **Single ownership.** The sole proprietorship is managed, owned and controlled by a single individual. All investment in the business is provided by that single individual only. He is the only source of capital for the business which he may arrange either through his own wealth or with the help of borrowed funds.
2. **Easy formation.** It is very easy to form proprietorship. In most of the cases even licence is not required except in the case of beer shops. Peddlers, hawkers, small vendors and shopkeepers can start business at their own will, provided it is not illegal, anti-social and against the public interest.
3. **Limited resources.** In case of sole proprietorship the owner is an individual. Resources of an individual are always small and

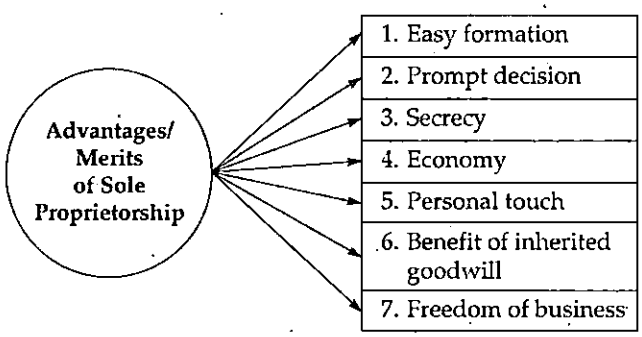
limited as compared to the resources of the group. It also suffers from the limited ability and limited capital of the owner.

4. **Unlimited liability.** The sole proprietor enjoys the excellent profit of the business but sometimes he is himself eaten up by the loss of the business. In case of loss and outstanding debts even his personal property is at stake. Dues of the business can be realised even by sale and auction of his personal property.
5. **Freedom of choice of the business.** The sole trader is free to choose the business of his choice, provided the business is not illegal and against the public interest.
6. **Prompt decision.** The sole proprietor, being the sole owner of the business is capable of taking immediate decision and avail of the business opportunities, whenever available.
7. **No separate legal entity.** A sole proprietorship form of business has no legal identity which can be separated from that of its owner. The owner and the enterprise are same in the eyes of law. Hence there is co-existence between business and the owner.

Taking prompt decision and implementing them at once is always in the interest of the business.

4.2.2 Advantages/Merits of Sole Proprietorship

The sole proprietorship has got the following advantages:



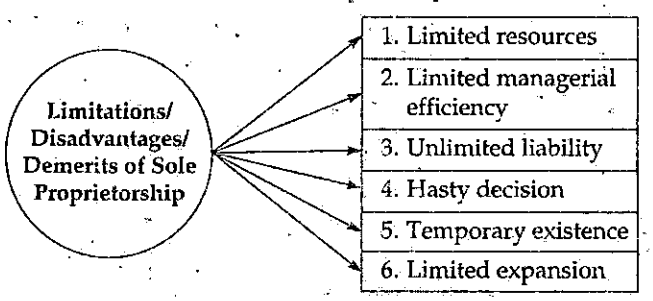
1. **Easy formation.** It is very easy to form a sole proprietorship. It can be started with small capital, average ability and limited resources. In certain types of business licence is required.
2. **Prompt decision.** Sole proprietor, being the only owner of the business is capable enough to take his own immediate decision regarding business problems. It enables him to avail of the business opportunities, whenever they are available.
3. **Secrecy.** It is easy to keep, and maintain secrecy in case of sole trade, because all the secrets lie with the owner himself. It is difficult to maintain secrecy in case of partnership and company, because secrets are shared among owners and possibility of leakage increases.

4. **Economy.** Sole proprietorship can be formed with small capital and the least expenses. As there are no legal formalities, so there are no legal expenses. All these make the sole trade economical.
5. **Personal touch.** The sole trade is generally located in the villages, streets, mohallas and colonies. He has the locals and neighbours as customers. As such, he develops intimacy, friendship and family relationship with the customers.

   Sometimes he is the friend, philosopher and guide of his customers. With this novel method he expands his business.
6. **Benefit of inherited goodwill.** The ownership of the business is passed on to the legal successor of the businessman and as such the goodwill is also transferred. The young entrepreneur is benefitted by the inherited goodwill.
7. **Freedom of business.** Everyone is free to carry on the business and choose any sort of the business according to his choice. There is almost no restriction in the formation of sole proprietorship.

4.2.3 Limitations/Disadvantages/Demerits of Sole Proprietorship

The sole proprietorship suffers from the following limitations:



1. **Limited resources.** Sole proprietorship is owned by an individual, so the resources accumulated by one person are limited and scarce as compared to the capital of partnership and company, where capital is contributed by many persons.
2. **Limited managerial efficiency.** The proprietor being an individual cannot be the master of all the branches of the business. He cannot be the expert of purchase, sales, accounts, production and marketing etc. As such sole trade suffers from limited managerial efficiency.
3. **Unlimited liability.** The liability of the individual owner is unlimited. It is not restricted to business but the personal property is at stake to meet the losses and debts of the business.
4. **Hasty decision.** The sole trader being the wholesole incharge of the business takes immediate decision. Sometimes these decisions are taken in haste which prove to be incorrect in future. Consequently, the firm has to suffer.

5. **Temporary existence.** The entire sole proprietorship centres around an individual, so any mishappening with the owner of the business such as illness, absence due to social customs and death adversally affects the business and sometimes the firm is dissolved.
6. **Limited expansion.** Since sole proprietorship form of business is owned, managed and controlled by an individual only, hence the resources and capital are restricted which further limits the scope of expansion of such form of business.

4.2.4 Suitability of Sole Trade

Sole trade is the oldest and simplest form of business organisation. Inspite of the modern large sized companies and corporations, sole trade is still flourishing, because of its simplicity, easy formation, quick decision, personal touch with business and customers. Sole trade is the most suitable form of business organisation in the following cases:

(*i*) If the size of the business is small.

(*ii*) If small amount of capital is required.

(*iii*) Sole trade is suitable for artistic articles, specially in cases, where the goods are to be produced to suit the personal taste of the customer.

(*iv*) Sole trade is suitable for services.

(*v*) If the business activities are confined to season, sole trade is good form of business.

(*vi*) Where secrecy is to be maintained.

(*vii*) If the market of the commodity is local.

(*viii*) If immediate business decisions are taken.

(*ix*) Where the business risk is lesser.

4.2.5 Future Prospects of Sole Proprietorship

The sole proprietorship has got its own specialities, so other form of business organisation cannot replace it. Everyone wants to have his own business. He is emotionally attached to his own work. He has got personal touch with the business. Everyone has limited resources and at the same time he has got his ambitions in life. In order to achieve his ambitions in business with the limited means, sole-proprietorship is the only form of business organisation. As such, there is no danger to the future of sole proprietorship. It has got prosperous future which will last for ever.

According to **WR Basset** "*one man control is the best control in the world, if that one man is so big that he can handle the entire affairs of the business*". The learned author wants to convey that, if the sole proprietor has got the perfect knowledge of his work, sufficient experience, direction and supervision ability and competence in management, control

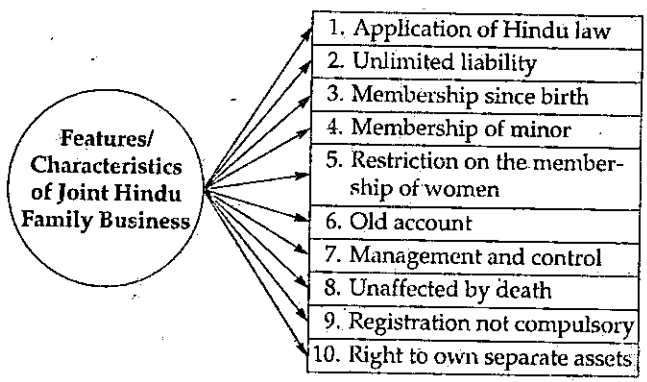
and leadership, one man business is definitely the best form of business organisation. The sole proprietorship will last for ever because of its simplicity, easy formation, personal touch and emotional attachment.

4.3 JOINT HINDU FAMILY BUSINESS

Joint Hindu Family business is the form of business, which is owned by the members of a Joint Hindu family. It is also known as *Hindu undivided family business (HUF).* It is unique Indian business institution, governed by the provisions of Hindu law. It is managed by the head of the family, known as Karta, whose liability is unlimited. The liability of other members is limited. The male child attains the membership of the family business, since his birth in the family. It has the following special features.

4.3.1 Features/Characteristics of Joint Hindu Family Business

Joint Hindu family business has got the following important features:



1. **Application of Hindu Law.** Hindu family business is started and conducted under Hindu succession Act, 1956. Rights and duties of the head of the family and members of the family are determined by the Hindu Law.
2. **Unlimited liability.** The liability of the head of the family is unlimited, whereas the liability of the members is limited to the value of assets held by them in the family business.
3. **Membership since birth.** The child becomes the member of the family business since his birth in the family. He also gets a share in the ancestral property since birth.
4. **Membership of minor.** It is the only form of business, wherein the minor male child automatically becomes its coparcener by birth in the family.
5. **Restriction on the membership of women.** Only males are the members of the Hindu family business. Females are not its co-owner. According to **'Mitakshara'** law women cannot become the member of the business. According to **'Dayabhag'** law women can

become member under certain conditions. According to **Hindu Succession Act, 1956** wives, after the death of their husbands can become the member of the family business.

6. **Old account.** The member of the Hindu family business cannot ask for the old account from the head of the family.
7. **Management and control.** The responsibility of management and control is entrusted to the head of the family who is major. Only the head of the family has right to borrow money and enter into important contracts.
8. **Unaffected by death.** Hindu family business continues even after the death of the member or even the head of the family. It is unlike partnership, which is no more after the death of its partner.
9. **Registration not compulsory.** Joint Hindu family business need not to be compulsorily registered.
10. **Right to own separate assets.** Every member has right to own separate property.

The inheritance of Joint Hindu Family Business is categorised as 'Dayabhaga' and 'Mitakshara'. 'Dayabhaga' system is generally found in West Bengal, Assam and some parts of Orissa under which both **'males and females'** can be members of the family business. The Mitakshara' system is seen in the rest India. In this system **only males** can be members of the family business.

Success Story of Haldiram

The history of this brand commenced from Bikaner in 1937. Now, it has become a brand of around ₹ 1500 crore and it began as a corner shop. Tansukhdas originally started the business of selling 'bhujiya' but the product gained popularity when his son Gangabhisan started a new setup. It is said that his another name was Haldiram which has taken forward by his youngest son Rameshwar Lal by opening a shop in Kolkata by the name 'Haldiram Bhujiyawala'. This name became the stepping stone for the future success. Hence, the success story of Haldiram is considered as an example of Hindu undivided family business.

Evaluation of Joint Hindu Family Business

Advantages/Merits	Disadvantages/Demerits/Limitations
1. Automatic formation	1. Limited stability
2. Freedom of business	2. Limited capital
3. Economy	3. Limited managerial ability
4. Secrecy	4. No link between responsibility and reward
5. Freedom of decision making	5. Too much power of karta
6. Cordial relations	
7. Efficient management of the business	

Advantages/Merits of Joint Hindu Family Business

Joint Hindu family business has got its own specialities. Though it looks like partnership but it is not managed by Partnership Act. The main advantages of this type of business are as under:

1. **Automatic formation.** This is automatically formed without any legal restriction.
2. **Freedom of business.** Joint Hindu family has freedom of choice as regards the type of business. It can carry on any legal business.
3. **Economy.** The head of the family has unlimited liability, so he should be careful, judicious and economical in his expenditures.
4. **Secrecy.** The head of the family business, known as 'Karta' enters into important contracts. He himself knows the secrets of the business and is capable of maintaining business secrecy.
5. **Freedom of decision making.** Though it is joint family business but the important decisions are taken by the 'Karta' independently. The decisions of 'Karta' are binding upon other members of family.
6. **Cordial relations.** Joint Hindu family business is located at the same place for many generations, so the customers residing in the locality have family and intimate relation. As such the family business inherits goodwill. This type of business has cordial relationship with the workers, who have been working in the business since childhood.
7. **Efficient management of the business.** Joint Hindu family business being ancestoral, its members are acquainted with the various aspects of the business and its management. The sufficient experience makes members good managers of the business.

4.3.2 Disadvantages/Demerits/Limitations of Joint Hindu Family Business

Joint Hindu family business suffers from the following demerits:

1. **Limited stability.** The basic requirement for this type of business is joint family system. With the break of the joint family, Joint family business is no more. This is why, this form of business in general is not stable.
2. **Limited Capital.** Joint Hindu family business cannot be carried on very large scale, because the capital contributed by the members of the family is generally insufficient for large scale business.
3. **Limited managerial ability.** Modern business is complicated and complex. As such family training is not sufficient. The 'Karta' of the family, even if he is very intelligent, cannot manage every aspect of the business with equal efficiency. This form of business is not at all suitable for large sized business.
4. **No link between responsibility and reward.** The 'Karta', the head of the family is responsible for managing the business single-handed. He bears the entire liability for the debts of the family

business alone. For all these responsibilities he is not paid any extra amount as remuneration or any extra profit. He gets his share of profit only as other coparceners get their share of profit.

5. **Too much power of karta.** The Joint Hindu family business is completely under direct control and influence to 'karta'. All the major decisions related to business are exclusively taken by him. An inefficient and incompetent 'karta' may not be able to take rational decision and hence can ruin the business forever.

4.4 PARTNERSHIP

Sole proprietorship, as we know suffers from unlimited liability, limited resources, hasty decision and temporary existence etc., so we tried to search for such a form of business organisation which could dispense with these demerits of sole proprietorship. As a remedy partnership emerged as a form of business organisation.

Definition of Partnership

Partnership as such is an agreement between two or more persons to carry on legal business with profit motive, carried on by all or any one of them acting for all.

According to **Indian Partnership Act, 1932** *"Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any one of them acting for all".*

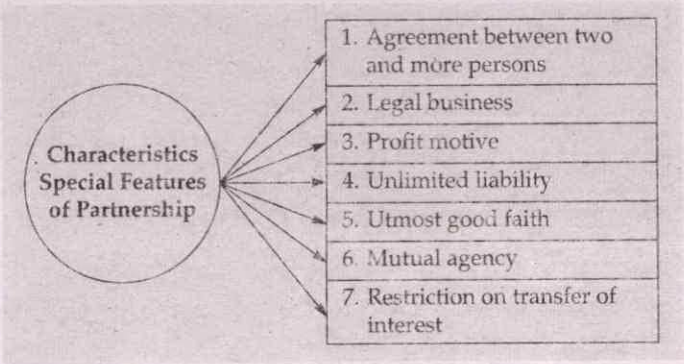
In the words of **L.H. Haney,** *"partnership is the relation between persons competent to make contracts who have agreed to carry on a lawful business in common with a view to private gain".*

According to the **Indian Contract Act,** *"partnership is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business and to share the profits there from between them".*

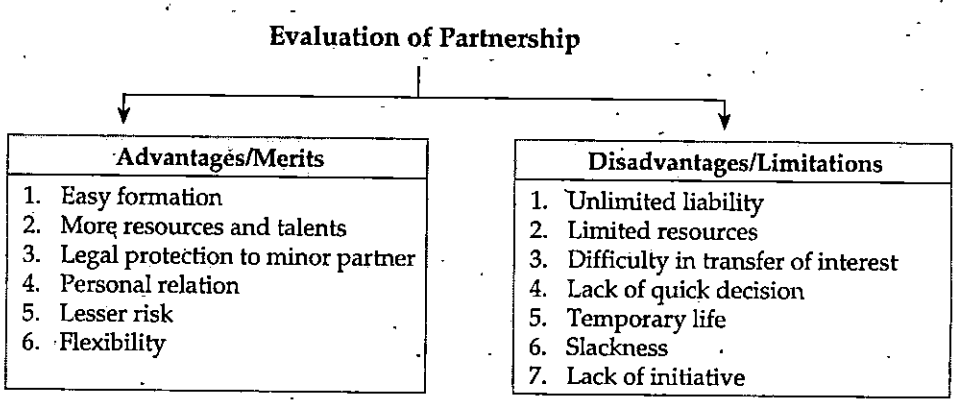
According to the **Kimball and Kimball,** *"A partnership firm is a group of men who have joined capital or services for prosecuting".*

4.4.1 Characteristics/Special Features of Partnership

Special features of the partnership are as under:



1. **Agreement between two and more persons.** Partnership is an agreement between two or more persons. The minimum number of partners is two and the maximum number of persons in case of banking business is ten and in case of other business is twenty.
2. **Legal business.** The business carried on by the partnership firm must be legal. It means that stealing, burglary, pick-pocketing, smuggling etc. are not the business in the eyes of law.
3. **Profit motive.** The business carried on by the partnership firm must have profit motive. In this way, orphanage, free dispensary charitable trusts etc. cannot become partnership. The partners share the profit in the ratio mentioned in the partnership deed.
4. **Unlimited liability.** Every partner of the firm is individually and jointly liable for the dues and debts of the firm. In other words, the liability of individual partner is not restricted to the amount of capital invested by him. It may be even more than that, if other partners are financially unsound/insolvent.
5. **Utmost good faith.** Partners are individually different. It will be fatal for the business if they behave individually in their own way in the business affair. Partners must integrate and co-ordinate their efforts and work as team with utmost good faith on each other.
6. **Mutual agency.** Every partner is the agent of the firm. Partners are also the mutual agent of each other.
7. **Restriction on transfer of interest.** The partners cannot transfer their interest *i.e.,* share in the business to other persons. Any change in the partnership can be affected through mutual consent. A new partner can be admitted or old partners may retire with the mutual consent.



4.4.2 Merits/Advantages of Partnership

A partnership firm enjoys the following advantages:

1. **Easy formation.** It is very easy to form partnership. It does not require any legal formality. It can be formed with simple agreement. Even its registration is not compulsory.

2. **More resources and talents.** The partnership has resources contributed by most ten persons in banking and twenty persons in other businesses. It is also the combination of the talents of many persons, working as partners.
3. **Legal protection to minor partner.** A minor can be admitted into the partnership for profit only. He will neither be a party to losses nor his private property will be at stake. As such minor's interest is protected in the partnership.
4. **Personal relation.** The number of partners being limited in the partnership, there is sufficient possibility to develop intimate relationship with the customer, employees and other persons.
5. **Lesser risk.** Loss is shared among partners, thus share of loss for each partner is lesser than the loss suffered by a sole proprietor.
6. **Flexibility.** Expansion and contraction of partnership as per requirement is possible.

4.4.3 Disadvantages/Limitations of Partnership

The partnership firms suffer from the following disadvantages:

1. **Unlimited liability.** Every partner is jointly and individually liable for the losses and liability of the firm, so the partners may have to bear unlimited liability.
2. **Limited resources.** Though partnership has generally more resources than the sole trade but its resources as compared to joint stock company having unlimited number of shareholders is lesser.
3. **Difficulty in transfer of interest.** A partner cannot transfer his interest in the partnership at his own will to any other person. A partner can retire and new partner can be admitted with the consent of all partners.
4. **Lack of quick decision.** Important decisions are taken with the consent of all partners, so sometimes opportunities are missed.
5. **Temporary life.** The partnership is dissolved with the death, lunacy, incapability and insolvency of a partner, so its life is temporary.
6. **Slackness.** Every partner is entitled to take active part in the business activities. As the work is not properly distributed, there is omission and duplication of certain pieces of work. Emergence of mistrust and misunderstanding leading to slackness is common feature.
7. **Lack of initiative.** Partnership is the victim of careless and indifference of the partners. As the partnership is owned by many partners, so the individual partner does not take utmost initiative and interest and consequently the partnership suffers.

Partnership–A Success

Google is one of the most popular partnership companies formed by Larry Page and Sergey Brin in 1998. Apple also started as a partnership in 1976 by Steve Jobs and Steve Wozniak. Even Twitter was started as a partnership. The reknowned computer brand HP was also formed as a partnership business between Bill Hewlett and Dave Packard in 1939. Baskin–Robbins is another successful partnership between Burt Baskin and Irv Robbins formed in 1945 in Glendale, California. The company is Reknown for its original 32 flavours of icecreams world wide.

4.4.4 Partnership Deed

Partnership owes its formation to mutual agreement between partners. This agreement may be **oral or written or implied** in the conduct of persons concerned. It is always in the interest of the partnership firm to have agreement in writing. The written document of the agreement is called **Partnership deed.**

Contents of the Partnership Deed

An ideal partnership deed should contain provisions regarding the following:

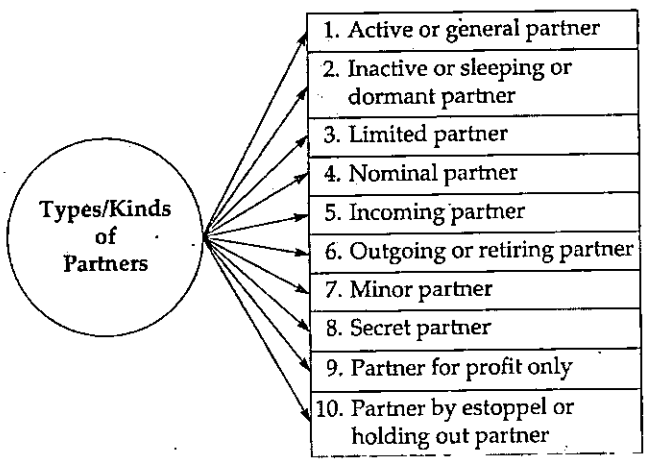
1. **Name and address of the firm:**
   (*i*) The name of the firm should not be the same of an existing firm. It should be independent. It should also not be very identical to an existing firm. It means that the name of the firm should not be misleading.
   (*ii*) The name of the firm should not be objectionable to the government. It should also not appear that the firm is a public enterprise.
2. **Names and addresses of partners.** Names and addresses of partners must be clearly written in the partnership deed.
3. **Duration of the partnership, if any.** In case the partnership has been formed for certain specified period, that specified period must be mentioned. If the partnership firm has been formed for certain specific purpose, that purpose should also be specified.
4. **Nature of the business.** Partnership deed must mention the nature, type, size and form of the business. It should specify whether it will be manufacturing or trading business. If trading, it will be wholesale or retail business. Other specialities, if any should also be mentioned.
5. **Profit sharing ratio.** The ratio in which partners will share profit or loss should be clearly mentioned in the deed. In the absence of any profit sharing ratio, profit/loss are shared equally among partners.
6. Amount of capital contribution by each partner.
7. Rate of interest on capital, if allowed.
8. Amount permitted to be drawn by each partner and rate of interest chargeable on drawings, if any.

9. Remuneration payable to partners, if any as salary, fee and commission.
10. Procedure to be followed in case of admission and retirement of a partner.
11. Procedure for dissolution of the firm.
12. Rights and duties of partners.

4.4.5 Types/Kinds of Partners

According to the provisions of **Indian Partnership Act, 1932** *ordinarily all partners have got equal rights, duties and status.* Practically, on the basis of their ability, efficiency and rights partners are classified as under:

1. **Active or general partner.** The partner, who takes active part in the affairs of the firm is known as active partner. The liability of active partner is unlimited. Such partner binds the firms with his affairs, contract and deeds.
2. **Inactive or sleeping or dormant partner.** Inactive partner does not take part in the affairs of the firm. He invests his capital and gets his share of profit. The liabilities of the sleeping partner is also unlimited. He has the same rights, duties and status as enjoyed by active partners.



3. **Limited partner.** The partner, whose liability is limited to the amount of capital invested by the partner is known as limited partner. All the partners of a firm cannot be limited partners, otherwise the firm will be illegal.
4. **Nominal partner.** Any person, who permits the firm to use his name as partner is known as nominal partner. Such a partner is neither the real partner of the firm nor the gets share of the profit. The liabilities of this partner is also unlimited. He is also liable to pay the amount due to outside parties.
5. **Incoming partner.** The partner, who is admitted fresh in the firm is known as new or incoming partner. Such a partner can be admitted with the consent of all partners. The incoming partner brings his capital and share of goodwill.

6. **Outgoing or retiring partner.** The partner who retires from the firm with the consent of other partners is termed as retiring partner. The outgoing partner must serve notice to the general public that he has retired from the firm, otherwise he will be liable to third parties for the payment of their debts and dues even after his retirement.
7. **Minor partner.** The partner, who has not attained the age of 18 years is known as minor partner. A minor is not competent to enter into contract, so he cannot become the partner of the firm but he can be made a partner with the consent of other partners for the profit only.
8. **Secret partner.** The person, who is the partner of the firm in the real sense but keeps this fact a secret is known as secret partner. Legally this type of partner also has unlimited liability.
9. **Partner for profit only.** This partner has an agreement with the other partners that he will be partner for profit only. This partner does not take part in the working of the firm but he is liable to the parties for their debts and dues just like other partners.
10. **Partner by estoppel or holding out partner.** In case, any person represents himself by words or actions or has allowed himself to be represented as a partner of the firm even though he is not the partner of the firm, he is supposed to be holding out partner. The liability of such partner will arise, if any outside party lends money or has dealing with the firm supposing the person to be the partner of the firm and the firm is not in a position to repay debt.

As this partner neither contributes capital nor takes a share in the profit he is not a partner in real sense.

4.4.6 Formation/Registration of Partnership Firm

Indian Partnership Act, 1932 does not make the registration of partnership firm compulsory. The unregistered firm has to face a lot of difficulties and it has no existence in the eyes of law. As such it is always in the interest of the firm to get itself registered. The firm has to fulfill the following formalities for its registration:

Formalities of Registration

The firm is required to apply to the registrar of firms on the prescribed form with the requisite fee.

Contents of the Application form for Registration

1. The name of the firm.
2. Place and address of the firm.
3. Names of those places where the firm intends to work.
4. The names and full addresses of all partners.
5. Dates on which various partners joined the firm.
6. The duration of the firm.
7. The date from which the firm will commence its business.

The Registrar of firm scrutinises the application form for registration and if satisfied, the firm is registered. After registration the firm is required to communicate the changes made in the size and constitution of the firm to the Registrar of firms.

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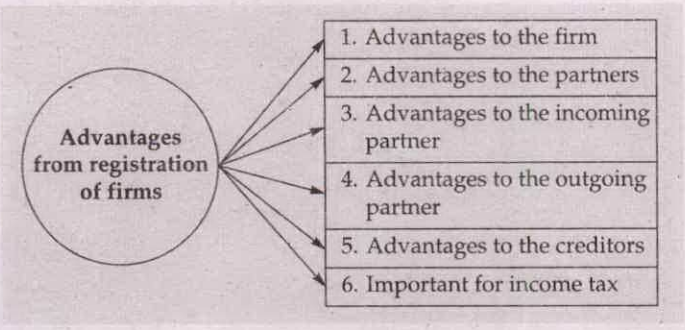
Advantages from Registration of Firms

A registered firm enjoys the following benefits:

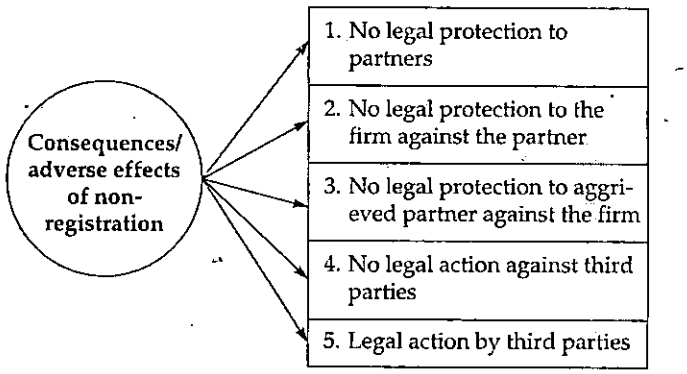


1. **Advantages to the firm.** The firm after its registration becomes a legal entity and enjoys all the legal protection. A registered firm can file a suit against third parties for the realisation of its debts and dues.
2. **Advantages to the partners:**
   (*i*) A partner of the registered firm can file a suit against other partners for the protection of his rights.
   (*ii*) The partner can file a suit against third parties for the protection of its interest.
3. **Advantages to the incoming partner.** The incoming partner obtains a copy of the registration of the firm from registrar of firms and acquaints himself with the real status of the firm and its partners. It enables him to understand the real worth of the firm and decides whether to join the firm or not.
4. **Advantages to the outgoing partner.** The retiring partner will intimate the registrar of firms—the date of its retirement and thus he will not be liable for all the dealings and agreement taking place after that date.
5. **Advantages to the creditors.** It is easy to realise dues from the registered firm and its partners. As partners are jointly and individually liable for the debts of the firm. The partners of the registered firm cannot escape responsibility.
6. **Important for income tax.** If a firm is not registered with the income tax authorities, it will be charged income tax on whole of its income, whereas in case of registered firm, the profit of the firm is divided between partners and income tax is charged on the incomes of the partners individually. The income tax authorities may charge income tax on individual partner's share of the profit in case of unregistered firm, if it suits their interest.

4.4.7 Consequences/Adverse Effects of Non-registration

An unregistered firm suffers from the following discomforts and inconveniences:

1. **No legal protection to partners.** No partner can file a suit in the court against any other partner for the protection of his interest.



2. **No legal protection to the firm against the partner.** An unregistered firm cannot file a suit against a partner for his misdeeds, such as theft, fraud, embezzlement etc., because an unregistered firm does not have any existense in the eyes of law.
3. **No legal protection to aggrieved partner against the firm.** The partner cannot file suit against the unregistered firm to redress his grievances, if any.
4. **No legal action against third parties.** An unregistered firm cannot file a suit against the third party for legal protection, because such a firm does not have legal existence in the eyes of law.
5. **Legal action against the unregistered firm by third parties.** Though an unregistered firm cannot file a suit against third parties but the third parties can file a suit against the unregistered firm for redressal of its grievances.

Rights of the Partners of Unregistered Firm as a Citizen

No doubt, the partners of an unregistered firm are the citizens of the country, so they enjoy the following rights as a citizen:

1. Right to file a suit against third parties for an amount not exceeding ₹ 300.
2. Every partner has right to get a share in the property of the firm, whether the firm is registered or unregistered.
3. Right of the partners to ask for the financial accounts of the firm after its dissolution.
4. Filing a suit in the court for grievances outside the agreement.

4.4.8 Kinds/Types of Partnership

The various types of partnership are as under:

1. **Partnership at will.** According to Section 7 of Partnership Act, 1932 every partnership which can be dissolved at will is known as 'Partnership at will'. Generally partnerships are at will, unless their duration and purpose is specified.
2. **Partnership for specific purpose.** This partnership is formed for certain predetermined purpose and the partnership is automatically dissolved after the objective is achieved. For example, partnership formed to construct a bridge or building will automatically get dissolved after the construction of building or bridge.
3. **Partnership for specific period.** These partnerships are formed for certain predetermined period. After the period or in certain cases extended period is over partnership is no more. For example, formation of partnership to sell handloom cloth in any national or international exhibition.
4. **Ordinary partnership.** All the partnership firms registered under Partnership Act, 1932 are said to be ordinary partnerships. If the partnership firm is not registered, it will not be ordinary partnership.
5. **Limited partnership.** The partnership firms, whose one or more partners have liability limited to the capital invested by them and the liability of other partners being unlimited is known as limited partnership. This partnership is formed on the basis of special agreements. We do not have such partnership in India.

4.5 COOPERATIVE SOCIETIES

It was felt in the early nineteenth century that economic conditions of the weaker sections of the people can improve *by cooperation not by competition.* As such persons living in the same locality and having common needs join together in the form of association, known as cooperative organisation for mutual benefit. As this is a cooperative organisation, profit motive is missing and it is replaced by *service motive*. In case there is surplus, it is distributed among members equitably honouring the principle of *distributive justice*. Dividend is paid on the basis of per member not per share.

Definition of Cooperative Societies

In the words of **Saligman,** *"Cooperation in its technical sense means abandonment of competition in distribution and production and elimination of middleman of all kind".*

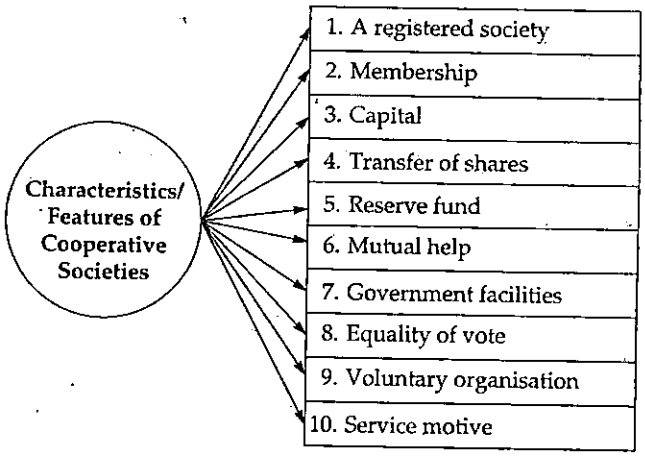
In the words of **Sir Horace Plankatte**, *"Cooperation is self help made effective by organisation".*

In the words of **H.C. Calvert,** *"Coorperative is a form of organisation, wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of a economic interest to themselves".*

According to the **Indian Cooperative Societies Act 1912,** *"Cooperative organisation is "a society which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles".*

According to **International Labour Organisation,** *"Cooperative is an association of persons usually of limited means, who have voluntarily joined together to achieve a common economic end through the formation of a democratically controlled business organisation".*

As such cooperative societies are voluntary association of persons having common need joining together for mutual benefit.



4.5.1 Characteristics/Features of Cooperative Societies

The cooperative societies have the following important features:

1. **A registered society.** All cooperative societies must be registered with the Registrar, cooperative societies of their state. A cooperative society without registration has no legal existence.
2. **Membership.** A major person, who has attained the age of 18 years can become the member of the cooperative society.
3. **Capital.** The capital of the cooperative society is distributed into small parts, known as shares. A member cannot subscribe for more than 10% of the total capital. No member can subscribe for share capital exceeding ₹ 1000.
4. **Transfer of shares.** Shares of cooperative societies are not transferable. These shares cannot be purchased and sold in the open market.
5. **Reserve fund.** 25% of the profit of the cooperative society is retained as Reserve Fund.
6. **Mutual help.** The basic idea behind the formation of cooperative society is the mutual assistance of its members.
7. **Government facilities.** The government has exempted cooperative societies from making payment of registration fee, stamp duty, income tax etc. The agreement keeps control on their activities.
8. **Equality of vote.** Every shareholder has one vote irrespective of the number of shares held by him. The fundamental principle of cooperative organisation is 'one shareholder, one vote'.

9. **Voluntary organisation.** Cooperative societies are voluntary organisation. No one is compelled to become its member. People opt for its membership at their own will.
10. **Service motive.** Cooperative societies are formed with service motive. Earning profit is their subsidiary objective. The society, aims to save people from the exploitations.

Characteristics/Features of Business Risk

- A Registered Society
- Capital
- Reserve Fund
- Government Facilities
- Voluntary Organisation
- Membership
- Transfer of Shares
- Mutual Help
- Equality of Vote
- Service Motive

4.5.2 Formation of Cooperative Societies

Cooperative societies are formed under Indian Cooperative Societies Act, 1912. Bengal, Bihar, Orissa, Maharashtra and Chennai have their own different societies Act. Persons eager to form cooperative societies have to apply to the Registrar of Cooperative Societies of their state. The application form must contain the following information:

1. Names and addresses of at least ten major persons.
2. Every member must belong to the same locality *i.e.*, village, town, mohalla etc.
3. Name of the proposed cooperative society.
4. Objective of the proposed society.
5. Details of share capital.
6. Rights, duties and responsibilities of the members.
7. Procedure for obtaining membership.
8. Articles of association (Internal rules) for the operation of the society.

If the Registrar of the Societies is satisfied with the furnished information, cooperative society is registered as a distinct legal entity.

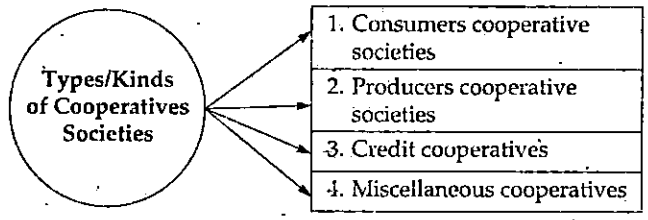
SHREYAS Cooperative Credit Society

Shreyas cooperative credit society Ltd. Ahmedabad is popularly known as 'Shreyas' in the city of Ahmedabad. It was set up in July 1955 with 41 members and share capital of ₹ 1000. In order to provide more and more services to its consumers the management decided to enter into consumer business soon. The main motive was to do maximum good to the maximum people. Earlier the society was formed to provide credit facilities to the mill workers but as it entered into consumer business, it aimed at providing better quality products at very reasonable prices. Today the society earns handsome amount of profit and has created a name for it, especially in the city of Gujarat having various retail outlets in middle class areas to serve lower income group.

4.5.3 Types/Kinds of Cooperative Societies

Cooperative societies on the basis of their objectives are classified as under:

1. **Consumers cooperative societies.** The first consumers cooperative society was established in Germany by 28 weavers with a capital of 28 pounds. This is an organisation of consumers. It is formed by consumers in order to protect their own interest. Its aim is to eliminate intermediaries like whole seller and retailers from the distribution channel. Other persons, who are not the members of the society can also purchase goods from them. In case of short supply of a particular commodity, members are accorded with priority. Sometimes special discount is allowed to members.



The consumer cooperative societies deal in commodities of daily use. Super Bazar and its branches in Delhi are the example of consumer cooperative.

2. **Producers cooperative societies.** It is an organisation of workers formed to produce/manufacture commodities. If the worker produces goods himself alone, he will have to arrange all the factors of production himself, which is not an easy task. If workers form producers cooperative societies, they will be benefitted in two ways. They will work and get salaries and on other hand they will get dividend also as the member of society. These societies are classified as under:

   (*i*) Raw material producing cooperative societies

   (*ii*) Producers cooperative societies.

3. **Credit cooperatives.** These cooperatives are formed to improve the economic conditions of its members. Their main objective is to save the poor people from the clutches of the indigenous bankers *i.e.* Seths, Sahukars and Mahajans. These credit cooperative societies grant short term loans to its members at cheaper rate of interest. The society issues shares which are subscribed by its members. The government also grants loans to these societies at concessional rates. Members can also make deposit with the societies. Financial assistance to weaker sections of the people is the main objective of these credit cooperatives.

4. **Miscellaneous cooperatives.** There may be different kinds of societies based upon regions and the requirements of the members.

Certain important cooperatives are as under:

(*i*) House Building Cooperative Societies

(*ii*) Marketing Cooperative Societies

(*iii*) Cooperative Farming Societies

(*iv*) Multipurpose Cooperative Societies

(*v*) Other Cooperative Societies

(*vi*) Central Cooperative Societies.

(*i*) *House Building Cooperative Societies.* These cooperatives are formed by those persons who do not own houses. Low income group people cannot purchase land and construct their own houses by investing large sum of money in big cities. These people form cooperative housing societies which purchase land on concessional rates from development authorities and municipal corporations and constructs flats. These flats are allotted to the members. Sometimes plots are provided to members, who construct their own houses. These societies play an important role in the urban housing, because flats are constructed on approved lands with civic amenities and that too at concessional rates and payment made in instalments.

(*ii*) *Marketing Cooperative Societies.* It is the voluntary association of small producers and artisans. The objective behind their formation is to secure remunerative price for their members. As the produced goods are sold by the society alone, so it increases their bargaining capacity and fetches handsome price. Goods produced by individual member producer is pooled up and sold through marketing cooperative. Sales proceeds are distributed among members on the basis of product supplied by them to the cooperative. Marketing cooperative is a step towards the elimination of unwanted middlemen, who eat up the Lion's share of profit. These cooperatives provide sometimes financial assistance to their members.

These marketing cooperatives provide the following facilities to their members: (*a*) Transportation (*b*) Warehousing (*c*) Grading (*d*) Packing and (*e*) Market research etc.

(*iii*) *Cooperative Farming Societies.* It is a voluntary organisation of poor farmers. They join together and form cooperatives. It is an effort to avail of the economies of large scale farming. Land is cultivated collectively and there is collective farming, which maximises the total production. It eliminates the loss accruing to farmers from excessive subdivision of land. It increases agricultural production by mechanising agriculture. It reduces the cost of management and generates fellow feeling among farmers.

(*iv*) *Multipurpose Cooperative Societies.* These societies are formed to render various services to their members. Their activity zone is not restricted to particular service. Farmers multipurpose society may arrange loans for farmers, organising sales of their

agricultural products, making agricultural equipments, high yield variety seeds, fertilisers and irrigation facilities available to the farmers. These societies can also assist in dairy farming etc.

(v) *Other Cooperative Societies.* These societies may include:

(a) Transport Cooperatives

(b) Milk distribution Societies

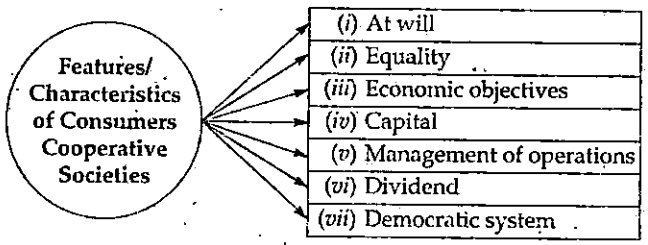
(c) Publishers Cooperatives

(d) Better living Societies etc.

(vi) *Central Cooperative Societies.* These societies are formed to manage, supervise, organise, regulate and according financial assistance to primary cooperatives. Central cooperative banks, State cooperative banks etc. are its example. These central cooperatives may be formed in any area, field, profession, where individual efforts and resources cannot achieve the desired results.

4.5.4 Features/Characteristics of Consumer Cooperatives Societies

The special features of consumer cooperative societies are as under:



(i) *At will.* Membership of consumers cooperatives is voluntary. It means that membership is not forced upon to unwilling persons. It is granted at will.

(ii) *Equality.* Every member has got one vote to cast, irrespective of the number of shares held by him. It proves that members have equal rights.

(iii) *Economic objectives.* These consumer cooperative stores have economic objectives *i.e.*, earning profit with service motive. They try to supply better quality of goods at reasonable price.

(iv) *Capital.* The capital of these stores is contributed by its members.

(v) *Management of operations.* These cooperative stores are managed by the elected office bearers of the society.

(vi) *Dividend.* A fixed percentage of the profit is retained as general reserve. The remaining profit is distributed among members generally in the form of gifts. Dividend is paid on *the basis of per member instead per share.*

(vii) *Democratic system.* The concept of consumers cooperatives is based upon the principles of democracy.

Evaluation of Consumer Cooperative Societies

Advantages/Merits	*Disadvantages/Limitations*
(*i*) Availability of cheaper and better quality of goods (*ii*) Less managerial expense (*iii*) No bad debts (*iv*) Advantages of location (*v*) Dividend	(*i*) No cooperative spirit (*ii*) Inefficient management (*iii*) Ignorance of members (*iv*) Exploitation of members

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4.5.5 Advantages of Consumer Cooperative Societies

Consumer cooperative societies enjoy the following advantages:

(*i*) *Availability of cheaper and better quality of goods*. The cooperative societies purchase standard quality of goods at wholesale price and sell it at reasonable price to its members.

(*ii*) *Less managerial expense*. The cooperative society is managed by the elected office bearers, who work honorary, so the cost of managing the society is lesser than any other form of business.

(*iii*) *No bad debts*. Cooperative societies sell their goods for cash. As credit sales are not made or credit sales are made to approved customers only there is no possibility of bad debts.

(*iv*) *Advantages of location*. The consumer cooperative societies are located amidst consumers in the locality. Consequently they make excellent sales and enjoy the benefits of location.

(*v*) *Dividend*. In addition to purchasing standard quality of goods at reasonable rates dividend is also paid, generally in the form of gift.

4.5.6 Disadvantages of Consumer Cooperative Societies

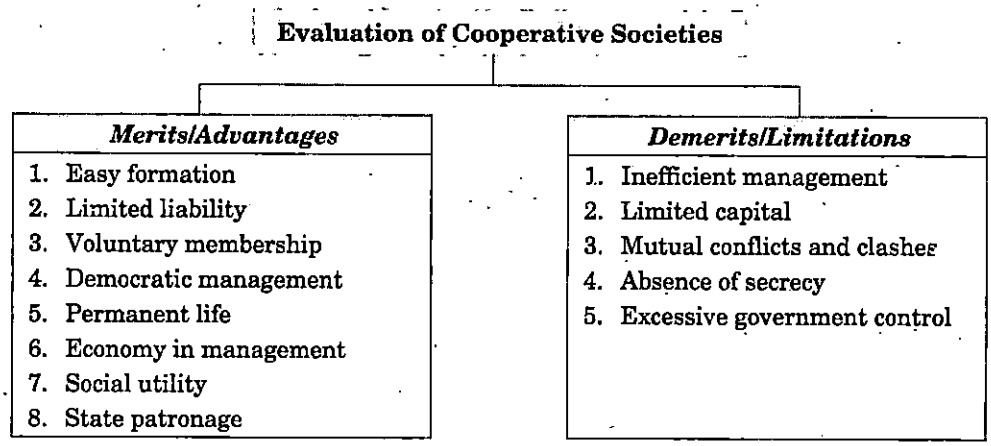
Consumer cooperatives societies suffer from the following disadvantages:

(*i*) *No cooperative spirit*. Theoretically, there is cooperation among members, but practically cooperative spirit is missing. Office bearers have their own selfish motives. In most of the cases office bearers exploit the resources in their own benefits.

(*ii*) *Inefficient management*. The consumer cooperative society is managed by the office bearers, who are not experienced enough to manage the cooperative business. The inexperience and incompetency leads to the unpleasant closure of the stores.

(*iii*) *Ignorance of members*. Members of the cooperative stores are ignorant about its constitution and working, so they are not able to avail of the opportunity and concessions provided by the stores and the government.

(*iv*) *Exploitation of members*. There are some wicked and cunning members and the majority of members are innocent. Consequently the innocent members are exploited.



4.5.7 Merits/Advantages of Cooperative Societies

Cooperative societies enjoy the following advantages:

1. **Easy formation.** Procedure for the formation of cooperative societies is very simple, less expensive and also less time consuming.
2. **Limited liability.** The liability of member is limited to the amount of share capital introduced by the member. Every member knows his risk involved in the cooperative society.
3. **Voluntary membership.** A person having common interest may join and leave the society at his own will. Membership is open irrespective of religion, caste and sex.
4. **Democratic management.** Every member has one vote irrespective of the amount of shares subscribed by him. The principle of 'one man one vote' is followed. Office bearers are the elected representative of the members.
5. **Permanent life.** A cooperative society is separate legal entity distinct from its members. The death, lunacy, disability and insolvency of its members does not affect its existence. As such it is a stable organisation enjoying continuity of business.
6. **Economy in management.** The society is managed by the members themselves, who provide honorary services to the society. As members belong to the same locality and have common interest, the management is efficient also.
7. **Social utility.** Mutual cooperation, distributive justice, decentralisation of power, open membership and democratic set-up makes cooperative societies social utility.
8. **State patronage.** The cooperative societies develop the spirit of brotherhood, mutual cooperation, honesty, self-dependence and self-respect. It helps weaker sections of the society in standing upon their own legs. It generates social consciousness. This is why, the govt. patronises them by extending different types of concessions and assistance.

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4.5.8 Limitations/Demerits/Disadvantages of Cooperative Societies

Cooperative societies suffer from the following disadvantages:

1. **Inefficient management.** Cooperative societies are managed by the elected representatives of the members. These persons are not competent enough to manage the society efficiently.
2. **Limited capital.** Cooperative societies are generally established by the weaker section of the society for their mutual help. The resources of these people is meagre, so it has limited capital.
3. **Mutual conflicts and clashes.** Members of cooperative societies generally have selfish motives, so they mutually clash each other. Consequently, the work suffers and the society is the loser.
4. **Absence of secrecy.** The society cannot maintain secrecy, because every member may have access to its accounts and its affairs are discussed openly in the meeting of its members.
5. **Excessive government control.** Cooperative societies are not independent in their working. Their activities, records and accounts are inspected and audited by cooperative inspectors and auditors. As such due to excessive government control, the people understand societies as government institution.

4.6 COMPANY

A joint stock company is an artificial person, created by law with a fixed capital, divisible into transferable shares, with perpetual succession and common seal. The company has a separate legal entity. It must be compulsorily registered. The company is owned by shareholders, who subscribe for its shares. It is managed by the board of directors, the elected representatives of shareholders. In this way, the management and ownership is practically different. The company has permanent life, it enjoys perpectual succession and is not at all affected by the death, insolvency, or lunacy or bankruptcy of its members. The liability of the shareholders is limited to the face value of shares held by a particular shareholder.

Definition of Company

According to **Haney**, *"A joint stock company is a voluntary association of persons for profit, whose capital is divided into transferable shares and ownership is required for its membership."*

In the opinion of **Kimbal and Kimbel** *"Corporation by nature is an artificial person, which is created by law for specific purpose or authorised."*

In the words of **Chief Justice Marshall** *"A joint stock company is an artificial person, invisible, intangible and existing only in the eyes of law."*

4.6.1 Special Features/Characteristics of Company

A joint stock company has the following important features:

1. **An Association of Persons.** At least two persons or seven persons must unite together to form private or public company. A single individual can't constitute a company.

2. **Incorporated Association.** A company comes into existence only after a certificate of incorporation in case of private and certificate of comencement in case of public companies.
3. **Transferability of Shares.** Members of public Ltd. company are free to transfer shares held by them to either purchase or sell shares.
4. **Separation of ownership from management.** Shareholders are the owners of the company but it does not give them the right to manage the affairs of company. The management is vested by Board of Directors who are the legal representatives of shareholders. Thus, the Board of Directors have a direct control over the company and all important decisions regarding the company are taken by Board of Directors.
5. **Artificial person.** A company is a separate legal entity. It purchases and sells goods in its own name. It incurs expenses and receives income in its own name. It can sue and can be sued by its partners creditors on any other third party. All important documents of company bears common seal. As such the company behaves like human being but it is actually not a natural person, so it is called artificial person.
6. **Created by law.** The company is formed, carried on and even wound up by observing legal formalities. The company has to apply to the Registrar of Companies of the state with memorandum of Association, Articles of association and prospectus etc. for the certificate of incorporation. After filing certain other documents, certificate to commence the business is received.
7. **Fixed capital.** The capital of the company is fixed and mentioned in the Memorandum of Association. This capital is divided into transferable shares. It may not be the paid-up capital of the company. It is the authorised capital, which the company has been authorised to obtain at any stage of its life.
8. **Limited liability.** The most important feature of the joint stock company is that the liability of its shareholders is limited to the face value of shares allotted to him. For example, if a shareholder has been allotted ten shares of rupees ten each, his liability will be limited to ₹ 100 only, even if the company suffers losses worth crores of rupees.
9. **Perpectual succession (Permanent life).** The company has got permanent life. It goes on continuing inspite of the death, incapability, lunacy insolvency and bankruptcy of its shareholders. The company has distinct legal identity and existence, separate from its shareholders. There is a separation between the ownership and management of the company. The company is owned by shareholders and managed by the board of directors, the elected representatives of shareholders. Members may come and go but company continue its operations as long as it fulfills the requirement of law.

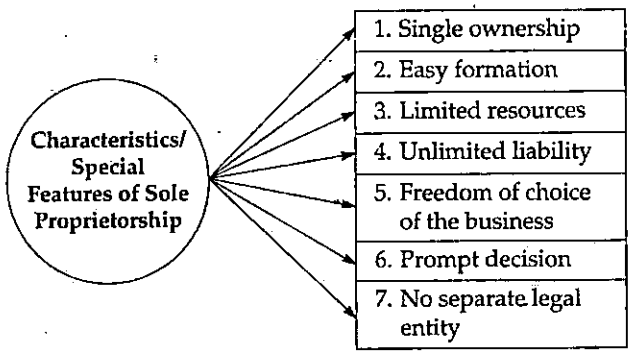
10. **Separate legal entity.** A company is said to have a separate legal identity. It can continue business in its own name. It can enter into contracts and transactions in its own name. It can sue and can be sued by its creditors. The company and its members are treated as separate individuals.
11. **Common seal.** Every company has common seal. The name of the company is engraved on the common seal. Every document of the company bears this seal. The company is an artificial person, so common seal as the symbol of company's signature holds importance. Any one acting on behalf of the company must affix the seal of the company together with its signature.

Characteristics of Company

- An Association of Persons
- Incorporated Association
- Transferability of Shares
- Separation of Ownership from Management
- Artificial Person
- Created by Law
- Fixed Capital
- Limited Liability
- Perpectual Succession
- Separate Legal Entity
- Common Seal

4.6.2 Types of Company

1. **Public Company.** According to Section 3 (1) (iv) of Indian Companies Act, "*A public company is one which is not a private company*". The provision restricting the number of shareholders, transferability of shares and issuing prospectus applicable in case of private companies does not apply in Public Companies. In other words, a public company is the company wherein:



(*i*) Minimum number of members is 7 and no limit regarding maximum member

(*ii*) There is no restriction on the transferability of shares

(*iii*) Maximum number of shareholders is not restricted to 50.

(*iv*) There is complete freedom to issue prospectus and invite application for shares and debentures.

Examples of Public Companies

Bajaj Auto Limited, Associated Cement Companies Limited, Oswal Agro Limited etc.

2. **Private Company.** According to Section 3 (1) (*iii*) of Indian Companies Act, 1956. A private company means a company which by its articles:
   (*i*) *Restricts the right to transfer its shares,* if any
   (*ii*) *Limits the number of its members* (*excluding* its present or past employees) to 50 and
   (*iii*) *Prohibits* any invitation to the public to subscribe for shares or debentures of the company.

It is the mixed form of Partnership and public company. It is a *Limited Liability Company registered under the Indian Companies Act*. It is necessary for the private company to use the word *'Private Limited'* after its name.

4.6.3 Special Privileges of Private Company

1. **Number of members.** A private company can be formed with at least two members.
2. **Allotment before minimum subscription.** The private company can make allotment of shares even before the minimum subscription is received.
3. **Prospectus.** The private companies need not issue prospectus or file statement in lieu of prospectus with the Registrar of Companies.
4. **Commencement of business.** It can commence its business after receiving incorporation certificate, whereas a public company can commence business after receiving certificate to commence business.
5. **Number of directors.** It requires only two directors.
6. **Statutory meetings.** Private company is not required to hold statutory meetings and file statutory report with the Registrar of Companies.
7. **Index of members.** It is not required to keep and maintain index of members.
8. **Issue of deferred shares.** Private companies are free to issue deferred shares with disproportionate rights.
9. **Loan to directors.** It can grant loan to directors without the permission of the government.
10. **Qualification shares.** Directors of the private company may not have qualification shares.
11. **Age limit of directors.** Maximum age limit of for directors in case of public companies which does not apply for Private Companies.
12. **No restriction on the number of directors.** The private company can increase its number of directors without the permission of the government.
13. **Appointment of managing director.** The private company can appoint a person as managing director, who has already been working as the managing director of an other company.

14. **Quorum of directors meeting.** Only two directors are sufficient to constitute a quorum of the meeting.
15. **Retirement of directors by rotation.** The directors of private company need not retire by rotation.

NOTES

India's Most Valuable Companies

Private Companies	*Public Companies*
1. Reliance Industries	1. Oil and Natural Gas Corpn.
2. Bharti Airtel	2. NTPC
3. Infosys Technologies	3. NDMC
4. Reliance Communications	4. MMTC
5. DLF	5. State Bank of India
6. TATA Consultancy Services	6. Bharat Heavy Electricals
7. Larsen & Tubro	7. Steel Authority of India
8. ICICI Bank	8. Indian Oil Corpn.
9. ITC	9. Power Grid Corpn. of India
10. Reliance Petroleum	10. GAIL (India)

Source: *CMIE Prowess, BSE and Company Websites 2008.*

4.6.4 Merits/Advantages of Joint Stock Company

Evaluation of Joint Stock Company

Merits/Advantages	*Demerits/Disadvantages/ Limitations*
1. Permanent existence	1. Excessive legal formalities
2. Limited liability	2. Fraud by promoters
3. Availability of large capital	3. Speculation in shares
4. Transferability of shares	4. Lack of secrecy
5. Economies of large scale	5. Evils of large scale business
6. Tax relief	
7. Diffused risk	
8. Democratic management	

A joint stock company form of business organisation is blessed with the following advantages:

1. **Permanent existence.** The life of the company is permanent. It is not affected by the death, incapability, lunacy and insolvency of the shareholders. It has separate legal entity. The ownership and the management of the company changes smoothly without the dissolution of the company.
2. **Limited liability.** The maximum liability of the shareholders of the company is limited to the face value of shares held by him. The personal assets of the shareholders cannot be attached, even if the company is unable to meet the claims of outsiders.
3. **Availability of large capital.** The capital of the company is contributed by its shareholders, whose number is unlimited as much as the company requires. The face value of shares being

nominal and the liability of shareholders being limited, these shares are easily sold, and the required capital is collected.

4. **Transferability of shares.** The shares of the company are transferable easily. Whenever the shareholder wants the money back, he can obtain it by selling his shares. This special feature also ensures that the company will not be required to refund the capital. The shares of the company are purchased and sold in the stock exchange in the open market.
5. **Economies of large scale.** The company form of business organisation assumes very large size because of huge share capital and professional management. This is why, the company enjoys internal and external economies of large scale enterprise.
6. **Tax relief.** Tax laws offer certain developmental rebates and concessions on certain commodities of export promotion and for the establishment of industries in backward regions. The company is charged income tax at flat rate. As such the tax liability on higher income is comparatively lower.
7. **Diffused risk.** The risk of business is shared among the innumerable shareholders, so every shareholder has to bear nominal risk. This is not the case in proprietorship and partnership, where the loss has to be borne by the individual proprietor and limited number of partners of a firm individually or collectively.
8. **Democratic management.** A company is managed in democratic fashion. It is established by shareholders and works for them. The board of directors are elected by the shareholders. Hence it works like a democratic government and aims at maximisation of sharesholders wealth.

4.6.5 Demerits/Disadvantages/Limitations of Company

The company suffers from the following limitations:

1. **Excessive legal formalities.** Formation of company requires a lot of legal formalities and filing of several documents. It is time consuming and expensive. Delay in filing of reports invites punishment. All these formalities make the formation of company difficult.
2. **Fraud by promoters.** Sometimes promoters of companies play fraud in the formation of company. They conceal material facts and cheat the shareholders. They manipulate the books of accounts in their favour. Promoters are rich people. They gain the experience at the cost of investors' funds, because they are not going to lose anything.
3. **Speculation in shares.** The shares of the company are purchased and sold in the open market. This practice encourages speculation, an immoral activity.

4. **Lack of secrecy.** It is very difficult to maintain secrecy in the company. Every matter has to be discussed in the board of directors' meeting or in the annual general meeting of shareholders. This is why, there is delay in the decisions and sometimes opportunities are lost.
5. **Evils of large scale business.** The company is a large scale enterprise, so it naturally inherits the demerits of the large scale enterprise. There is clash of interest between the management and workers. Consequently strikes and lock-outs are the common features.

4.6.6 Formation of a Company—Stages

Joint stock company as we have discussed earlier is an legal entity. It has to follow legal procedures for its formation. The law does not interfere in the establishment of sole proprietorship and partnership. These forms of business organisation may and may not be registered. The company is formed, brought up and even wound up after following legal formalities. The company has to follow certain legal steps in its formation as under:

Steps/Stages/Procedure of Formation of a Company

The steps followed in the formation of a Company may be grouped as under:

A. Promotion of Company.

B. Incorporation or Registration of Company.

C. Commencement of Business.

A. *Promotion of Company*

It has been discussed earlier that the company is an artificial person, so it requires some one to conceive an idea of the company and decide about its form, size, type and structure. Those, who make a decision about these aspects are known as promoters.

Promoters may be an individual, firm or company responsible for the promotion of the company. Promoters discover business opportunities, make detailed investigation, assemble factors of production, make financial arrangement and combine them into profitable business venture.

Promotion of the company according to **Gerestenberg** is, "the discovering of business opportunities and the subsequent organisation of funds, property and management ability into business concern for the purpose of making profit therefrom".

Who is a Promoter?

A promoter is an individual, a firm, a company, an institution or even a Government department, who conceives the idea of exploiting a business opportunity, examining the idea whether it is worth working,

arrange men, money, material and machines and forming a profitable enterprise. The promoter identifies business opportunities, analyses its prospectus and initiates steps to form a company. The business opportunities may be:

(*i*) The idea of exploiting certain untapped natural resources.

(*ii*) An invention.

(*iii*) Novel selling techniques.

(*iv*) Manufacturing a product by new methods.

(*v*) Introducing product with new uses.

(*vi*) Introducing new type of packaging.

(*vii*) Capitalising a trading or commercial possibility.

Types of Promoters

Promoters may be classified into the following four categories:

1. **Professional Promoters.** Promoters, who hand over the control and management of the company to the Board of directors after its promotion are called Professional Promoters. These promoters are interested in the promotion of the company.
2. **Occasional Promoters.** The promoters promote company occasionally almost once. After the completion of task they return to their original occupation. They do not perform promotion activities regularly.
3. **Entrepreneur Promoters.** The promoters who conceive the idea of the business enterprise, perform promotional activities and finally become the part of management are known as entrepreneur promoters.
4. **Financier Promoters.** Promotion activities are sometimes performed by the financial institutions because of their experience in the financial affairs. These are known as financier promoters.
5. **Government.** In certain strategic sectors like defence, steel, banking etc. government may also become promoter in terms of setting up of the company. For example, Hindustan Motor Ltd., National Thermal Power Corporation etc. is a government promoted companies.

Importance of Promoter

Every corporate enterprise owes its existence to the promoter. It is the result of the planning and organising ability of the promoter. The enterprise visualises the light of the day due to determination, foresightedness and sustained efforts of the promoter. In the words of **Dr. Hoagland,** "*A successful promoter is a creator of wealth and an economic prophet*".

The promoter not only forms the mental picture of the enterprise that is actually non-existent but also visualises the problems it might face after coming into existence. The promoter ensures that the unborn entity should have smooth and easy going when it is promoted.

Role/Functions of Promoter/Stage of Promotion

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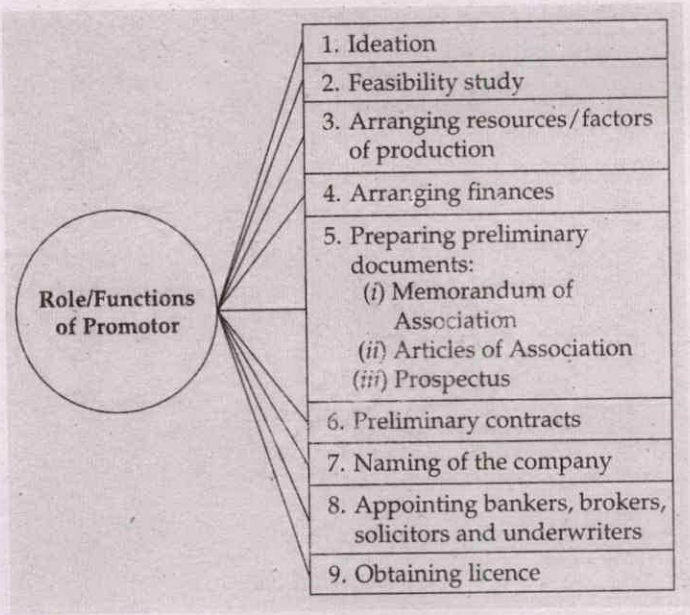


Promotion is the first step of the formation of company. It includes activities from ideation of company to obtaining licence. It includes the following functions :

1. **Ideation.** Ideation is the basis for every important activity. In this way, ideation is the first and foremost function of the Promoter. He must have an idea about the form, size, nature and object of the proposed company.
2. **Feasibility Study.** The promoter has to investigate that what sort of facilities are available at the place of establishing company. The promoter has to satisfy that the required piece of land, efficient workers, transportation and communication facilities and raw material is available or not.
3. **Arranging resources/factors of production.** The promoter has to make arrangement of sufficient funds. Though the company obtains its capital by issue if shares and debentures but the promoter has to make payment of certain expenses before the amount is received from issue of shares. As such the promoter has to use his own resources. He may contact banks, financial institutions and underwriters.
4. **Arranging finances.** If the promoter is satisfied after preliminary investigation that the idea is worth implementing and there is sufficient opportunity for profit, he contacts different persons and experts and enters into several deals regarding purchase of land, plant, machines etc.
5. **Preparing preliminary documents.** The promoter has to prepare important documents because these documents are compulsorily required for obtaining certificate of incorporation and commencement of business. The company requires Memorandum of Association

to define its objectives and activities. Articles of Association for its day-today working and prospectus for inviting people to subscribe for its shares and debentures.

6. **Preliminary contracts.** These contracts are made by the promoters before the incorporation of the company with different parties in the interest of the company. The promoter is personally liable for these contracts. The company after its incorporation generally approves these contracts. If these contracts are not approved by the company, the promoter will be personally liable for these contracts. This is why, the promoter has to be very cautious in making contacts.
7. **Naming of the company.** The promoter has to decide the name of the company. He should ensure that the name of the company should not be the same name or very identical name of an existing company.
8. **Appointing bankers, brokers, solicitors and underwriters.** The promoter has to make these appointments, which are required to be approved by the company.
9. **Obtaining licence.** The promoter should obtain the requisite licence for the business, if necessary.

In this way, *promotion is an activity of discovering business opportunity, making preliminary investigation, assembling factors of production, completing preliminary legal formalities and forming the company as a profitable venture.*

The promoter has got a relationship of trust and confidence with the company, so he should act honestly and sincerely in the best interest of the company. He should not misuse his position for personal gain.

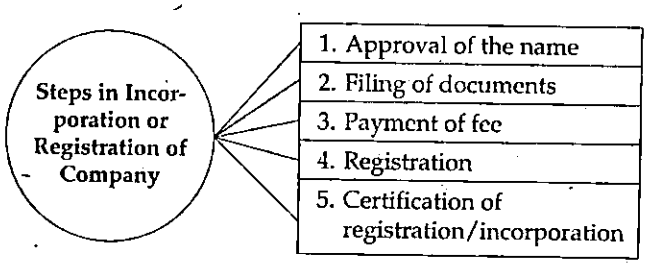
Legal Status of a Promoter

A promoter is neither the agent nor the trustee of the company. Legally he cannot be the agent of non existing company. It means that he will be personally liable for contracts, if they are not ratified.

The promoter is also not the trustee of the company. He is supposed to observe good faith in the promotion of the company and must not make secret gains out of the dealings. If there is gain out of the dealings, it must be disclosed.

B. Incorporation or Registration of Company

It is the second stage of the formation of company. Incorporation is the registration of the company as a body corporate under the Companies Act, 1956. It has to follow the following steps as per legal requirements :



1. **Approval of the name.** The proposed name of the company must be approved by the Registrar of Companies.
2. **Filing of documents.** The following documents are filed with the Registrar of Companies for incorporation :
   (*a*) *Memorandum of Association.* It is an important document of the company. It defines the objects of the company and establishes its relationship with the outside world. It contains name, capital, objectives, situation, liability and association clauses of the company.
   (*b*) *Articles of Association.* It is the byelaws of the company concerning its internal management. It is popularly known as doctrine of internal management. It must be signed by subscribers to the memorandum. The public company will be deemed to have adopted Table A in schedule I of the Companies Act, if it does not file its own articles of association.
   (*c*) *Notice.* As per Section 146 of the companies Act, notice regarding the situation of the office of the company must be served.
   (*d*) *The agreements.* As per the provisions of Section 33 of Indian Companies Act, the copy of the agreement if any, which the company proposes to enter into with any individual, firm or company should be filed.
   (*e*) *A list of directors.* The list of the directors with their names, addresses and other details has to be submitted with the Registrar of Companies.
   (*f*) *Written consent of the directors.* The proposed directors of the company must express their written consent that they have no objection in working as the director of the company. It is necessary that the director must subscribe for qualification shares.
   (*g*) *Statutory declaration.* It is necessary for the incorporation of the company that a statutory declaration signed by a director, manager or secretary of the company or by an advocate of Supreme Court or of a High Court or by a practising chartered accountant stating that all provisions of the Companies Act with regard to incorporation have been duly compiled with.
3. **Payment of fee.** The company must pay the prescribed filing and registration fee and stamp duty while filing the above documents. The registration fee varies with the amount of authorised capital.
4. **Registration.** The Registrar of Companies will carefully scrutinise the documents and if satisfied with the compliance of legal formalities regarding registration, he enters the name of the company in his register.
5. **Certification of registration/incorporation.** After the registration, the Registrar of Companies will issue the certificate of incorporation. It is signed by the Registrar of Companies specifying the date of issue. From the date of issue of incorporation certificate the company becomes distinct legal entity with perpetual succession and common seal.

Effect of the Certificate of Incorporation

A company is legally born on the date printed on the Certificate of Incorporation. It becomes a legal entity with perpetual succession on such date. It becomes entitled to enter into valid contracts. The certificate of incorporation is a conclusive evidence of the regularity of the incorporation of a company. Imagine, what would happen to an unsuspecting party with which the company enters into a contract, if it is later found that the incorporations of the company was improper and hence invalid. The legal position is that the company becomes a legal business entity irrespective of any flaw in its registration after it incorporation. As such the certificate of incorporation is the conclusive evidence of the legal existence of the company. The birth of the company cannot be questioned after its incorporation, even if it was registered with its legal objective. In such cases the only remedy lies to wind up the company.

SPECIMEN OF
CERTIFICATE OF INCORPORATION

I hereby certify that ..... (name of the company) is this day incorporated under the Companies Act 1956, and that the Company is limited.

Given under my hand at Delhi, this seventh day of November, two thousand and five.

Fees : Deed Stamp ₹ .....

Stamp Duty on Capital ₹ .....

SEAL

Sd/-
Registrar of Company
Delhi

Corporate Identity Number
of Company : 1352 of 2005

The private company can commence its business after issue of certificate of incorporation but a public company has to receive certificate to commence business.

Capital Subscription

The public company can raise funds from public by issue of shares and debentures. It is required to issue the prospectus, which is an invitation to the public to subscribe to the capital of the company. The company has to follow the following steps for raising funds from the public.

1. SEBI Approval
2. Filing of prospectus
3. Appointment of Banker, Brokers and Underwriters etc.
4. Minimum subscription.

NOTES

1. **SEBI approval.** SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for disclosure of information for investors' protection. A company inviting funds from general public must make adequate disclosure of all relevant information and must not conceal any material information from the potential investors. This is necessary for protecting the interest of the investors. Prior approval from SEBI is therefore, required before going ahead with raising funds from public.
2. **Filing of prospectus.** After receiving the approval from SEBI, a copy of the prospectus or statement in lieu of prospectus is filed with the registrar of the company. A prospectus is an offer or invitation to public for subscribing the shares and debentures of the company. It must disclose all material information. There should not be mis-statement.
3. **Appointment of banker, brokers and underwriters.** In case of raising funds from public Application money is received by the bankers of the company. The brokers try to mobilise funds by distributing application forms, underwriters undertake the responsibility to subscribe for shares, if applications fall short. The appointment of underwriter is not necessary.
4. **Minimum subscription.** Minimum subscription is the minimum amount required by the company for its preliminary functions. The limit of minimum subscription is 90 per cent of the size of the issue. Thus, if applications received for the shares are for an amount less than 90 per cent of the issue size, the allotment cannot be made and the application money received must be returned to the applicants. The public company can not allot its shares, so far minimum subscription has not been received. The application money received is kept deposited in the scheduled bank of the company, so far the allotment of shares has not been made. If the minimum subscription is not received the company will have to refund application money to shareholders. The amount of minimum subscription must be sufficient for the following requirements :
   (*i*) Payment of preliminary expenses.
   (*ii*) Payment for assets purchased.
   (*iii*) Meeting working capital requirements.
   (*iv*) Meeting other expenses.

The companies Act 1956 has laid much stress on minimum subscription in order to safeguard the interests of the shareholders. Before the enactment of companies Act, 1956, directors commenced business with insufficient funds, resulting in the winding up of company. The poor shareholder lost their money in the process. The minimum subscription clause does not apply for Private companies.

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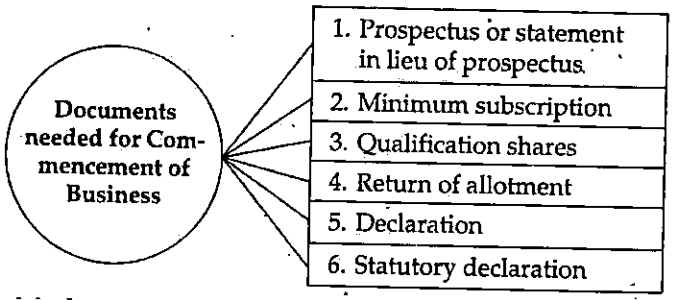
C. Commencement of Business



A private company can commence its business after its incorporation but the public company has to obtain certificate to commence business after filing the following documents:

1. **Prospectus or statement in lieu of prospectus.** A public company must file a copy of prospectus or statement in lieu of prospectus with the Registrar of Companies. A private company need not file a prospectus or statement in lieu of prospectus.
2. **Minimum subscription.** A public company cannot make allotment of shares unless minimum subscription has been received. This arrangement has been made in the act to safeguard the interest of shareholders. The company is required to file a declaration that the minimum subscription has been received in cash. This provision is not applicable to private company.
3. **Qualification shares.** It has been made compulsory for the directors of public company that they must take qualification shares and make payment for that. It shows that the proposed director must be a shareholder first in order to become a director. The company must make a declaration that the directors have subscribed for their qualification shares.
4. **Return of allotment.** The company is also required to submit a return of allotment containing the names and addresses of shareholders and the number of shares allotted to each.
5. **Declaration.** That the company has applied for or obtained permission for its shares to be dealt on a recognised stock exchange is filed.
6. **Statutory declaration.** Finally in order to obtain certificate to commence business a statutory declaration by a director or secretary of the company or from an advocate that necessary legal formalities have been complied with, has to be filed.

The registrar will scrutinise the above documents and if satisfied will issue certificate to commence business. The company will start the business from the date of issue of the certificate.

NOTES

Proforma for Statutory Declaration

"FORM NO. 1"

The Companies Act, 1956

Declaration of Compliance with requirements of the Companies Act, 1956 on Application for Registration of a Company.

PURSUANT TO SECTION 33(2)

NAME OF THE COMPANY : M/S.

PRESENTED BY : SUSHIL KR.

CHARTERED ACCOUNTANT.

I, ... (NAME OF CA) ..... Partner of ... (NAME OF CA FIRM & ITS ADDRESS) ..., do solemnly and sincerely declare that I am a Chartered Accountant in whole time practice in India, who is engaged in the formation of the company "M/S. .... PRIVATE LIMITED".

And that all the requirements of the Companies, Act, 1956 and the rules thereunder in respect of matters precedent to the registration of the said company and incidental there to have been complied with and I make this solemn declaration conscientiously believing the same to be true.

PLACE : NEW DELHI (NAME OF CA)

DATED : CHARTERED ACCOUNTANTS

CERTIFICATE OF COMMENCEMENT OF BUSINESS

(Specimen)

I hereby certify that ..... ltd. of ..... which was incorporated under the Companies Act, 1956, on the ..... day of ..... 200 ..... and which has this day filed a statutory declaration in the prescribed form that the conditions of section 149 has been complied with, is entitled to commence business.

Given under my hand at ..... this day of ..... two thousand .....

SEAL

Registrar

Joint Stock Companies

..... (State)

FORM NO. 1A

THE COMPANIES ACT. 1956

(APPLICATION FORM FOR AVAILABILITY OF NAMES*)

The Registrar of Companies,

.....

.....

Sir,

Subject : Availability of Names-information Furnishing of :

We, the following applicants are desirous of forming a company to be registered under the Companies Act, 1956, in the State Union Territory of ...

1. Name and full address of the person (s) applying for the availability, of the name (IN BLOCK CAPITALS).
2. Proposed name of the Company.
3. State Whether Public or Private.
4. In case of proposed name mentioned in item 2 is not available, 3 names to be considered, in the order of preference.
5. Main object of the proposed Company.
6. Name and address of the prospective Directors or Promoters, etc.
7. Particulars of the names and situation of Registered office of other companies in the same group or under the same management.
8. Proposed authorised capital.
9. Please furnish particulars and results of any application moved to this or any other Registrar previously for availability of name.
10. Particulars of remittance of fee

Situation .....

Dated ....

Signature of the applicant

* Refer Rule 4 A of the Companies/Central Government's/General Rules and Forms, 1956.

4.6.7 Basic Documents of the Company

The following are the main documents of the company:

1. Memorandum of Association
2. Articles of Association
3. Prospectus.

Memorandum of Association

Memorandum of Association is the most important basic legal document of the company. It is the charter of the company, which defines its objectives and determines the boundary line within which the company has to work. It can be said to be the foundation stone, upon which the future structure of the company will stand. Memorandum of Association establishes the relationship of the company with the outside world.

It is necessary for every individual firm, company and institution that while dealing with the company they must familiarise themselves with the memorandum of the company, because it is the charter of the company determining liability.

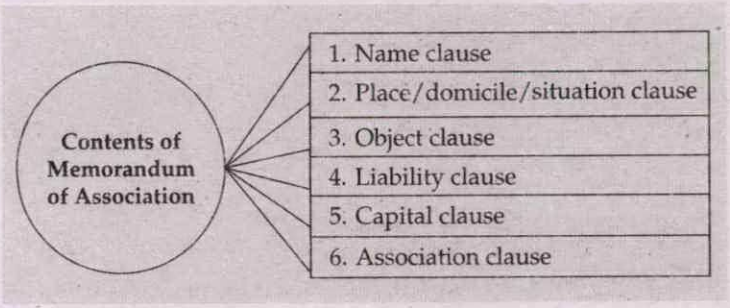
Definition of Memorandum of Association

According to **Section 2 (28) of the Companies Act, 1956,** *"Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this act."*

In the words of **Lord Cains**, *"The Memorandum of Association of a company is its charter and defines the limitations of powers of the company established under the Act. The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated."*

According to **Lord Macmillan**, *"The Memorandum of Association sets out the constitution of company. It is, so to speak, the charter of the company and provides the foundation on which the structure of the company is built."*

Contents of Memorandum of Association



The Memorandum of Association contains the following clauses:

1. **Name clause.** This clause contains the name of the company. While choosing the name of the company, company should take into consideration the following points:
   (*i*) The name should not be identical to or closely resembling an existing company.
   (*ii*) The name should not indicate that the company is patronised by the government.
   (*iii*) The name should not include the word 'cooperative'.
   (*iv*) The name of the company should be prominently affixed outside the premises of the company.
   (*v*) The name must be engraved on common seal.
2. **Place/domicile/situation clause.** Under this clause the name of the state in which the company is situated is mentioned. The registered office is the place, where all statutory books and documents of the company are kept. This address is used for correspondence from Registrar of Companies.
3. **Object clause.** Under this clause the main objects and other objects which the company may pursue are mentioned. The object must be legal and not against the public interest and policy. This clause must be clear in precise term, because it defines the power and activities of the company. The company must be very careful and cautious while drafting this clause.
4. **Liability clause.** It must be clearly stated in the Memorandum of Association that the liability of shareholder is limited to the

nominal value of share held by him. If the liability is limited by guarantee, it should be clearly specified.

5. **Capital clause.** Under this clause, the authorised capital of the company is mentioned. The types, numbers and denomination of shares should also be mentioned.
6. **Association clause.** The association clause reads, "we the several persons, whose names and addresses are submitted are desirous of being formed into a company in accordance with the memorandum of Association and we undertake to take the number of shares in the capital of the company mentioned opposite our respective names." In case of public company this declaration must be signed by at least seven persons and in case of private company, it must be signed by at least two persons.

MEMORANDUM OF ASSOCIATION
(SPECIMEN)

1. Name :

   The name of the company is Effierent Education Services Limited. It is herein after referred to as EES Ltd.

2. Registered Office :

   The registered office of the company shall be situated in the NCT of Delhi and at present it is at :

   Sri Aurobindo Marg, New Delhi-16

3. (A) : Main Objectives :

   (*a*) To engage in the design, development and delivery of world class service products in the sphere of education for domestic as well as global markets.

   (*b*) To establish and strengthen presence/market share in the various segments representing the various stages in the education/re-education process in the life-long learning context, viz., identification of prospects, curriculum design, pedagogy, examination & evaluation, anticipating societal/market needs, content-delivery, placement services and human resource development and renewal.

   (*c*) To develop, publish/produce teaching, training and study materials, journals, periodicals, reports, books, monographs and other multilingual literature/multimedia products for promoting the objectives of the company.

   (*d*) To organise programmes, conferences, lectures, seminars symposia and workshops on issues imparting education, industry, business and society.

3A (B) : Ancillary Objectives :

   (*a*) To develop special competencies and capabilities for designing, developing and delivering service products for persons with physical and mental disabilities;

(*b*) To liaison and network with the various individuals and institutions in government and non-government sectors and fostering mutually beneficial relationship in the field of education;

(*c*) To host a website for virtual learning;

(*d*) To build up a research and reference library and to undertake documentation services;

(*e*) To own, purchase, lease, movable and immovable property in furtherance of the aims and objectives of the company;

(*f*) To offer prizes, grants, stipends and scholarships in furtherance of the objectives of company;

(*g*) To provide a forum for raising, discussing and resolving of issues, problems and challenges in the field of education; and

(*h*) To do generally all such other lawful things as are conductive or incidental to the attainment of the above objectives;

4. Liability Clause

Liability of the members would be limited to the amount of unpaid value of the share.

5. Capital Subscription Clause

The company shall be registered with a capital of ₹ 2.5 crore divided into 25, lakh shares of ₹10, each.

We the following persons voluntarily agreed to be the signatories to the Memorandum of Association

Sunita	Vinita
Anil Kumar	Sunil Kumar
Avtar Singh	Renu
Anita	Usha

The name and address of the company signatures to Memorandum have been modified.

Association Clause

The association clause reads as under.

"We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names."

2. Articles of Association

Articles of Association of the company deals with the administration of internal affairs of the company. It defines the duties, rights and powers of the management and board of directors. The articles of association of

the company must be printed, divided into paragraphs and numbered. The signatories to the memorandum must sign it in the presence of witness. Generally Companies have their own articles but they may adopt the model Articles given in Table 'A' of Companies Act.

Contents of the Articles of Association

Certain important matters listed in the Articles of Association are as under :

(*i*) The amount of share capital and different classes of shares.

(*ii*) Rights of each class of shareholders.

(*iii*) Details of contracts made with different persons.

(*iv*) Procedure for making allotment of shares.

(*v*) Procedure for issuing share certificate.

(*vi*) Procedure for transfer of shares.

(*vii*) Procedure for forfeiture and reissue of forfeited shares.

(*viii*) Procedure for conducting meeting.

(*ix*) Procedure for appointment, removal and remuneration of directors and their power and duties.

(*x*) Procedure for declaration and payment of dividend.

(*xi*) Matters relating to keeping of statutory books.

(*xii*) Procedure regarding alteration of share capital.

(*xiii*) Procedure regarding winding up of the company.

Change in the Articles of Association

Change in the articles of association can be made by special resolution. The change must be compulsorily intimated to the Registrar of Companies. The Articles of Association is always dependent to the Memorandum of Association. If there is any clash between the provisions of Memorandum and Articles of association, the provisions of Memorandum of Association will hold good.

3. Prospectus

According to Section 2 (36) of Indian Companies Act, 1956. "Prospectus means document described or issued as prospectus and includes any notice, circular, advertisement or other documents inviting offers from the public for the subscription or purchase of any shares or debentures of a body corporate".

Prospectus as such is an invitation or offer to the public to subscribe for shares of company, if desired by them. It contains all material information required regarding financial aspects of the company and helps people in making decision, whether they should subscribe for shares of the company or not. Framing and preparing the prospectus is an art. The **company** depicts the picture of its golden future through prospectus and motivates the prospective shareholders to subscribe for the shares and debentures of the company. *Filing of prospectus is must by the public company before*

obtaining the certificate to commence business. A copy of the prospectus must be supplied with every application form. It is not necessary for every company to file prospectus. Private companies are not required to file a prospectus.

NOTES

Importance/Purpose of the Prospectus

1. Prospectus contains the *printed summary of the company's past history*, if any its *present status* and its *future prospects.*
2. It *informs the public* about the company and *stimulates people* to make an investment in the company.
3. It is an *authentic record* of terms and conditions on which the shares and debentures have been issued.
4. It shows *business policies* and programmes of the company.

Requisites of a Correct Prospectus

The prospectus must have the following specialities:

1. It must not be exaggerated.
2. It must contain a full and honest disclosures.
3. Material facts must be disclosed, not concealed.
4. There must not be false details and untrue statements.

Contents of Prospectus

1. Matters discussed in Memorandum of Association, Names, addresses and qualification shares of members signing on the memorandum.
2. Main object of the company.
3. Assets of the company and share of shareholders in the profit of company.
4. Number of qualification shares to be taken by the directors.
5. Distribution of the share capital of the company, types of shares, number and value of different types of shares and rights of the shareholders.
6. If redeemable preference shares have been issued, their numbers, method and date, when payment has to be made.
7. Names, addresses, profession and remuneration of directors and managers.
8. Minimum subscribed capital of the company.
9. Amount payable on application and allotment.
10. Date and time of receiving application money.
11. Number and amount of shares and debentures issued for consideration other than cash.
12. Name and addresses of underwriters.
13. Preliminary expenses and its estimated amount.
14. Amount payable to promoters.

15. Names and addresses of auditors.
16. Details of the interest of directors and promoters in the formation of company.
17. Details regarding all important contracts, their date and place.
18. Details of directors' and promoter's interest in the assets purchased by the company.
19. Amount of premium or discount allowed on shares, if shares have been issued at a price more or lesser than the face value of shares.
20. Name and addresses of those vendors who have sold assets to the company. Details regarding form of payment i.e. cash, shares or debentures.
21. Details of the voting rights etc. of the different classes of shares.
22. Rights of shareholders regarding receiving dividend and return of capital.
23. Method and restriction on the payment of dividend.
24. Other useful information regarding issue of shares and debentures.

Consequences of Misleading Prospectus

The persons, responsible for preparing false and misleading prospectus will face the civil and criminal liability.

1. **Civil liability.** In case, misleading prospectus amounts to misrepresentation, the aggrieved persons can repudiate the contract and claim refund of their money. Damages can also be claimed from the persons found guilty.
2. **Criminal liability.** In case any deliberate concealment is made, directors will be punished with a fine of ₹ 5,000 or imprisonment upto two years or both. If it is proved to be fraud the fine will extend to ₹ 10,000 or 5 years' imprisonment or both.

Statement in Lieu of Prospectus

A public company may not issue prospectus. In such a situation, it will have to file a statement in lieu of Prospectus with the Registrar of Companies. The proforma of the statement is given in the third schedule of companies Act. This statement must be filed at least 3 days before the allotment of shares. Like prospectus, it should also be true and not conceal material facts. It must be signed with date by all the directors.

Statement in lieu of prospectus is used in the following cases:

1. If the private company is changed into public company.
2. If there is automatic and immediate collection of capital at the time of incorporation.
3. If the company has not issued prospectus due to any reason.
4. If the company has decided that it will not issue shares or debentures to public.

SUMMARY

- **Sole Proprietorship.** Sole proprietorship is the form of business organisation, which is owned, managed and controlled by an individual, who is solely responsible for the results of the business 'operations'.
- **Future Prospects of Sole Proprietorship**

  One man control is the best control in the world, if that one man is so big that he can handle the entire affairs of the business alone.
- **Joint Hindu Family Business.** It is the form of business, which is owned by the members of a joint Hindu family.
- **Definition of Partnership.** It is an agreement between two or more persons to carry on legal business with profit motive, carried on by all or any one of them acting for all.
- **Partnership Deed**

  The written agreement between partners is known as partnership deed.
- **Types/Kinds of Partners**

  1. Active or general partner 2. Inactive or sleeping or dormant partner 3. Limited partner 4. Nominal partner 5. Incoming partner 6. Outgoing or retiring partner 7. Minor partner 8. Secret partner 9. Partner for profit only 10. Partner by estoppel or holding out partner.
- **Formation/Registration of Partnership Firm**

  Registration of partnership is not compulsory but it is useful.
- **Kinds/Types of Partnership**

  1. Partnership at will 2. Partnership for specific purpose 3. Partnership for specific period 4. Ordinary partnership 5. Limited partnership.
- **Definition of Cooperative Societies**

  It is voluntary organisation of adult persons having common interest for mutual benefit. It has got permanent life with existence, separate from its members.
- **Types/Kinds of Cooperative Societies**

  1. Consumer cooperative societies 2. Producer cooperative societies 3. Credit cooperatives 4. Miscellaneous cooperatives.
- **Meaning of a Joint Stock Company**

  Joint stock company is an artificial person created law, with fixed capital divided into transferable shares, with perpetual succession and common seal.
- **Types of Company**

  (*a*) Private Limited Company (*b*) Public Limited Company

- **Formation of a Company—Stages**

  Types of promoters 1. Professional promoters 2. Occasional promoters 3. Entrepreneur promoters 4. Financier promoters 5. Government.

- **Business Organisation**

  Business enterprises are economic entities concerned with the production, purchase, sale, transfer and exchange of goods and services on regular basis and with profit motive.

- **Characteristics of Business Organisation**

  (*i*) Economic activity (*ii*) Production, purchase, sale transfer and exchange of goods and services (*iii*) Profit motive (*iv*) Regularity (*v*) Satisfy human needs.

- **Choice of the form of Business Organisation**

  (*a*) Easy formation (*b*) Amount of the capital (*c*) Legal formalities (*d*) Government interference (*e*) Government policy (*f*) Degree of control desired and (*g*) Duration of business enterprises.

REVIEW QUESTIONS

1. Name the form of business organisation, which is more suitable in case of undeveloped economy and disorganised capital market.
2. What form of business will emerge in case of undeveloped and unorganised economy?
3. Mention any four limitations of sole proprietorship.
4. Explain five characteristics/features of Joint Hindu Family business.
5. What do you mean by cooperative organisation?
6. Define a private company.
7. What is public company?
8. What are the two important types of companies? Explain them.
9. Evaluate the sole proprietorship.
10. Explain the features of a Joint Hindu family business.
11. Define Partnership. Explain main features of partnership firm.
12. Discuss the merits and demerits of partnership firm.
13. What is partnership deed? Mention its contents.
14. What do you mean by cooperative organisation? Discuss important features of this organisation.
15. Elaborate the statement. "*Though cooperation is necessary in every walk of life, it is extremely useful in the field of business.*"
16. Define a private company. Describe privileges of a private company.
17. What is company? Mention its four advantages.
18. Explain briefly the characteristics of business organisation.
19. What factors should be taken into consideration while selecting the form of business organisation ?
20. Explain briefly factors to be considered for starting a business.

UNIT 5 MERGER, ACQUISITION AND RESTRUCTURING

NOTES

★ STRUCTURE ★

5.1 Introduction

5.2 Rationale Behind Mergers

5.3 Some Reasonable Reasons for Mergers

5.4 Some Unreasonable Reasons for Mergers

5.5 Steps and Procedures of Merger

5.6 Takeovers

5.7 Guidelines Stipulated by Securities and Exchange Board of India (SEBI)

5.8 Anti-Takeover Defences in India

5.9 Role of Financial Institutions

5.10 Joint Ventures

5.11 Portfolio Restructuring

5.12 Financial Restructuring

5.13 Concentrated Equity with Debt Components (Also Known as Leveraged Buyout)

5.14 Organisational Restructuring

5.15 Financial Evaluation of Divestiture

5.16 Guidelines for Managing Divestments

- Summary
- Review Questions

5.1 INTRODUCTION

Merger, acquisition and restructuring have, of late, become the major financial strategy and economic force, a dominant global business theme. The weapon of 'take over' (to use the word of David Sinclair) seems to be the most popular and frequently used mechanism in the business world, all over the world; and India is no exception. Corporate restructuring has been resorted to in many top business firms like Tata Motors, L&T, SBI and NOCIL, to name just a few.

Mergers and acquisitions involve various types of transactions, like merger itself, or the purchase of a division, or take overs, or joint ventures, and so on. Corporate restructuring, however, comprises portfolio restructuring, financial restructuring, and organizational restructuring.

5.2 RATIONALE BEHIND MERGERS

A merger involves a combination of two companies together: the one merging with the other, and a new company emerging therefrom. It may, however, take place in two ways: one involving 'absorption', and the other involving 'consolidation'. In the case of an 'absorption', one company acquires the other, that is to say that it absorbs the other company. Thus, it may well be said that the Ashok Leyland Limited had absorbed (that is, acquired) Ductron Castings Limited. In a consolidation transaction, on the other hand, two or more companies may combine themselves together so as to form a new company. For example, HCL Limited had been formed with the combination of four companies, viz. Hindustan Computers Limited, Hindustan Instruments Limited, Indian Software Company Limited, and Indian Reprographics Limited.

It may be noted here that, in the legal parlance in India, the mergers are referred to as 'amalgamations', and are generally in the nature of absorption.

Further, the acquiring company is also referred to as the amalgamated company or the merged company, and the acquired company is referred to as the amalgamating company, or the merging company, or even as the target company.

In a merger transaction, the acquiring company acquires both the assets and liabilities of the acquired company.

Moreover, the shareholders of the acquired company receive the shares of the acquiring company in exchange of their shares of the acquired company.

There may be various types of mergers. These are:

(i) Horizontal

(ii) Vertical

(iii) Conglomerate

(i) A horizontal merger comprises the merger of the companies which are engaged in the same line of business.

(ii) In the case of a vertical merger, however, the firms, engaged in different stages of the production of a similar product, amalgamate to form a new company.

(iii) As against the horizontal and vertical integrations, the conglomerate merger involves the merger of the companies, which are engaged in quite unrelated lines of activities.

The main and most significant rationale behind any merger deal is that the value of the new emerging company, after the merger of the two or more companies, is expected to be greater than the sum total of the value of all the merging companies, individually, taken together.

Some other rationales involved in favour of mergers are:

(i) Growth

(ii) Diversification

(iii) Economies of scale

(iv) Managerial effectiveness

(v) Utilization of tax shields

(vi) Lower costs of financing

(vii) Strategic advantages, etc.

But then, on a closer look and analysis, some of the rationale may sound reasonable in terms of creation of some value, while some others may seem to be rather doubtful, in that they may not be creating sufficient value, worth the name.

5.3 SOME REASONABLE REASONS FOR MERGERS

5.3.1 Economies of Scale

With the merger of two or more companies, the emerging company involves operations on a much larger scale, which, in turn, results in the economies of large scale production, and the other related business activities. The resultant advantages pertain to more intensive and effective utilization of the installed capacity of the plants and machinery, distribution channels, engineering services, data processing systems, research and development (R&D) facilities, etc. It may, however, be noted here that the economies of scale are more pronounced and visible in the cases of horizontal mergers (as against the vertical mergers), in as much as in such cases the scope and opportunity of effective and intense utilization of the resources are much greater, by virtue of the fact that the line of business of all the amalgamated companies happens to be the same or, at least, quite similar to each other. It, however, should not give the impression that vertical integrations do not result in any significant benefits and advantages. In fact, these are present even in the cases of vertical mergers, though these are of some different type and nature. For example,

(a) It results in an improved coordination of the different levels of production activities,

(b) It facilitates working with a relatively lower level of inventories, and thereby results in a substantial savings in the form of lower overall inventory carrying costs.

(c) The combined entity, emerging out of the vertically integrated companies, commands a much higher power and position in the market.

Further, in the cases of conglomerate mergers, too, the inherent advantages comprise the elimination or, at least, some reduction, in respect of certain overhead expenses.

But then, if the sub-optional operations are usually found to be uneconomical, even an oversized company may generally prove to be so. Therefore, due care must be taken to ensure that the resultant company, emerging out of such merger, does not become highly oversized to ultimately prove to be rather uneconomical and disadvantageous.

Accordingly, the resultant size should emerge and must be retained at the optimal level, that is, it should be neither too small nor too large (and hence unwieldy), but just about right, whereby the unit cost could be kept at the minimal level.

5.3.2 Strategic Advantages

Instead of resorting to the strategy of expansion, on an internal basis, it may prove to be advantageous (strategically, that is) if other company or companies, engaged in the similar business activity are acquired, along with their existing production facilities and marketing network, that go therewith. Some of such strategic edges and advantages are listed hereunder:

(a) It may result in the lack of or, at least, ease of competition, that would have otherwise arisen, if the acquired company, too, would have expanded internally and, thereby offered an increased quantum of competition and acquiring the additional market share.

(b) The merger option also results in a lot of saving of time, as such transactions enable the companies to skip the various stages involved in the usual internal expansion process.

(c) Such merger arrangements usually result in the cutting down of both the risks and cost factors, at the same time.

(d) And, more importantly, in a saturated market condition, where the scope of sustaining the expanded capacity is rather doubtful and full of risks, the strategy of merger seems to be undoubtedly the more advantageous option, inasmuch as it amounts to the expansion and replacement, both at the same time.

5.3.3 Synergy of Resources

There may be situations where the two companies in question may be found to be quite complementary and supplementary to each other. For example, a small unit may be having, or may be developing, some new innovative products and designs, but may be lacking the required technical and engineering capabilities, and even the market reach and network, of a large scale industry. Under such circumstances, the strategy of merger may well be found to be most suitable, so as to reap immense advantages of synergy of the complementary resources of the two separate economic units. In the process, the resultant joint production and profitability may prove to be far greater than the sum total of the total production and profitability of the two companies, working as two separate industrial units.

5.3.4 Advantages of Taxation

As we all know, a company may not carry forward its accumulated losses and/or unabsorbed depreciation for an indefinitely long period, with a view to deriving the advantages of tax concessions. But then, if such a company prefers to merge with a profit making company, its accumulated losses, and/or unabsorbed depreciation, get absorbed, automatically and immediately, in the quantum of the gross profit of the profit-making company. When the loss and unabsorbed depreciation get set off against the total income of the profit-making company, the resultant taxable income automatically goes down, and the tax liability, too, that goes therewith.

5.3.5 Gainful Investment of Surplus Funds

Some of the more profitable and cash rich companies somehow do not prefer to invest the surplus cash in some gainful sources of investment. They, instead, may resort to disbursement of dividends at a generously high rate, or else, may adopt the strategy of buying back of their own shares. But, as has been observed in some cases, the management of such companies prefer to make the investments for internal expansion, irrespective of whether such a strategy will ultimately prove to be profitable and accordingly wise, or otherwise. Under such a situation, it may prove to be much more sensible and desirable for the company to adopt the strategy of merging with another firm, which may involve some payment of cash, and thus, a better and more grainful employment of the surplus funds, available with such company.

5.3.6 Effective and Efficient Management

As has been revealed by several empirical studies, lack of managerial competence and control have been found to be one of the most common and valid causes of industrial sickness, both in the large, medium, and even small-scale sectors. Thus, it may augur well for a company, burdened with an inefficient and ineffective team of managers, to merge with another well-managed company, so as to reap the inherent advantages of effective management and control in respect of its affairs, too, in the post-merger situation. Besides, by way of a related benefit, such merger may result in a much greater congruence and compatibility between the managers and the shareholders.

It has often been found that a company, which is not being managed effectively, and hence not performing well, often becomes the easy target for acquisition. Thus, in the post-merger stage, the officers and executives of the acquired company, too, may pull up their socks and begin to perform at the peak of their knowledge, skill and efficiency, so as to retain their post and position in the new venture.

5.4 SOME UNREASONABLE REASONS FOR MERGERS

We will now go on to look into some of the arguments, which, in reality, may not be found to be adding and enhancing any value for the companies, though these may appear, on the face of it, to be rather plausible and convincing.

5.4.1 Diversification

The process of diversification may result in some substantial reduction in the risk elements between the two merging companies, but only where there may exist a negative correlation between the earnings of such two companies. As against this, the existence of a positive correlation between the earnings of the two merging companies may result in a much lesser reduction of risks.

Moreover, even the investors do not derive any benefit from the merger of such two companies with the objective of reduction of the risks, due to the diversification, inasmuch as they may, on their own, reduce the elements of risks by going in for purchase of the shares of the two companies (which are proposing to merge) from the stock market, in a suitable proportion. Besides, such self-made diversification may give them a much greater flexibility, in that they may buy the shares of these two companies in suitable proportions, and at the same time, they may have the option of changing its portfolio the way they may like, and whenever they may like, depending upon the changing circumstances and the stock market behaviour. As against this, they may get confronted and stuck with a fixed proportion of shares they may get in the event of the merger.

But such flexible option may not be available to the existing shareholders of the two merging companies, if the shares of both these companies, or even of one of them, are not quoted and traded in the stock market. Thus, under such conditions, the only flexible alternative seems to be by way of corporate diversification, especially under the circumstances where one of such merging companies is confronted with such problems, which may jeopardize its very existence. Thus, its merger with the other stronger company, may well save it from the imminent bankruptcy and getting wiped off from the economic and industrial scene.

5.4.2 Lower Financial Costs

It is generally believed that, by virtue of merger, the cost of borrowing may go down for the following main reasons:

(a) The merger will give rise to increase in the (joint) size of the new company, and its greater power of earnings, and the financial stability that goes therewith.

(b) The equity base of the (joint) emerging company will naturally go up, as it will be the combined stocks of the two or more merging companies.

(c) And, based on the aforesaid favourable factors, the creditors (both the banks and the sundry creditors) of the merged company, may feel more safe and secured and, therefore, may prefer to quote a somewhat favourable rate of interest and terms of credit sales, respectively.

But then, from the investors' (shareholders') point of view, the resultant increase in the level of equity, goes on to correspondingly enhance their own risk burden, related to their own funds, as against the loan or borrowed funds. Thus, on an ultimate analysis, the investors (shareholders) of the merging firms do not stand to gain much out the resultant mergers, in that the advantages of lower borrowing cost, if made available to the company, gets offset by the corresponding increased burden and risk of the own fund (equity) of the shareholders.

5.4.3 Growth in Income

There seems to be a general misconception and illusion that merger necessarily results in the growth in the income of the shareholders, which, in turn, may lead to a suitable increase in the market pricing of the shares of the companies, so merged. But this is not true, inasmuch as, in the event of a merger, the share holders of the merging company get the share of the merged company in proportion to their asset valuation and the prevailing market price.

For example, when the Reliance Petroleum Limited (RPL) had merged with the Reliance Industries Limited (RIL), the shareholders of the RPL had got the shares of RIL in the ratio of 1:11; i.e., is one share of RIL in exchange of 11 shares of RPL. And, the resultant fractional shareholdings were duly compensated by way of payment of the sale proceeds of the consolidated shares of such franctional holdings.

It has, however, been observed that in some cases the market price of the post-merger company goes up initially (though falsely) but finally, after some time, it gets stabilised at the realistic level, showing no increase, whatsoever.

5.5 STEPS AND PROCEDURES OF MERGER

A merger transaction involves three main considerations. These are:

- Legal provisions and procedures
- Provisions of taxation
- Accounting systems and procedures

5.5.1 Legal Provisions and Procedures

The legal procedure for a merger transaction involves the following steps and stages:

(i) **Examination of the Object Clauses:** As the very first step, the Memorandum of Association of both the merging companies must be referred to see:

(a) Whether the power to merge exists in both the cases, and

(b) Whether the object clause of the transferee (merged or amalgamated) company permits it to carry on the business of the transferor (merging or amalgamating) company. In the absence of such a clause, this clause has got to be incorporated in the Memorandum of Association, with the required approval of the shareholders, the board of directors, and the Company Law Board, as per the laid down procedures in law.

(ii) **Intimation to the Stock Exchange(s):** It is imperative that all the stock exchanges, wherein the shares of the merging and merged companies are listed, are duly informed about the proposed merger. Besides, the stock exchanges concerned must also be kept informed of the developments, from time to time, by sending the copies of all the documents, like the notices, resolutions, and orders, passed by the respective companies.

(iii) **Approval of the Draft Merger Proposal by the Respective Boards:** The respective Boards of Directors of the two companies must approve the draft merger proposal, and should also pass the resolution to the effect that the directors/executives are authorized to pursue the matter further.

(iv) **Application to the High Court:** The next step involves that each company must move an application to the High Court to seek the permission to convene a meeting of the shareholders and creditors for the purpose of passing and approving the merger proposal.

(v) **Despatch of Notices to the Shareholders and the Creditors:** Now comes the turn for sending, by each company, by post, the notices (along with the explanatory statements) for convening the separate meetings of the shareholders and the creditors, as approved by the High Court. It must, however, be ensured that the shareholders and the creditors of each company duly receive such notice at least twentyone days before the scheduled respective dates of such meetings. Besides, such notices need to be published in at least two daily newspapers (one of English and the other of vernacular). Further, an affidavit, too, should be filed in the Court to the effect that:

(a) The notices have been despatched to the shareholders and the creditors, and

(b) These have been published in two newspapers (one in English and the other in vernacular).

(vi) **Separate Meetings of the Shareholders and Creditors:** Two separate meetings, of the shareholders and the creditors of each

of the companies involved, should be held whenever the scheme of merger is required to be approved and passed by at least 75 per cent (in value) of the shareholders, in each class, and by the same at least 75 per cent (in value) of the creditors, who vote either in person or by proxy.

(vii) **Petition to the Court:** After the scheme of merger has been passed in the meetings of the shareholders and the creditors, separately, and in the cases of each of the companies involved, as aforesaid, the involved companies are required to file a petition in the Court of law for confirmation of the scheme of merger. Thereafter, the Court fixes up a date for the hearing. A notice about the date so fixed by the Court should be published in at least two newspapers, as aforesaid. Besides, the notice is also required to be served to the Regional Director, Company Law Board.

After hearing the points presented by all the parties concerned, and satisfying that the scheme of merger is fair and reasonable enough, the Court will go on to pass an order sanctioning the merger. It thus, goes to imply that the Court is within its powers even to modify the scheme of merger and, pass orders, accordingly.

(viii) **Filing of the Order with the Registrar of Companies**

(ix) **Certified copies of such Court order must be obtained and filed with the Registrar of Companies within the time period specified by the Court.**

(x) **Transfer of Assets and Liabilities:** After the passing of the final order(s) by the Court, the entire assets as also the liabilities of all the merging companies concerned, are to be transferred to the merged company, with effect from the appointed date.

(xi) **Lastly, after all the provisions of law have been fully fulfilled and duly completed, comes the turn of the issuance of the appropriate number of shares and debentures by the merged companies, which may later be listed on the stock exchange(s). However, in some cases, cash payments may have to be arranged.**

5.5.2 Provisions of Taxation

(i) **Depreciation:** For the purpose of taxation, the depreciation, to be charged by the merged (amalgamated) company is required to be computed on the basis of the 'written-down-value' of the assets, prior to the merger. But then, for the accounting (company law) proposes, it may be computed on the basis of the consideration (price) paid for the assets.

(ii) **Accumulated Losses and Unabsorbed Depreciation:** The accumulated losses and unabsorbed depreciation of the amalgamating

(merging) company may be considered to be the loss/depreciation of the amalgamated (merged) company for the preceding year in which the amalgamation has been made effective, provided the following conditions are satisfied:

(a) The amalgamating company owes an industrial unit or a ship.

(b) The amalgamated company continues to hold at least 75 per cent of the assets (in value) of the amalgamating company, which has been acquired in the process of amalgamation, at least for five years from the effective date of the amalgamation.

(c) The amalgamated company continues to be in the business of the amalgamating company for at least five years, and

(d) The amalgamated company satisfies such other conditions, too, as may be prescribed to ensure the revival of the business of the amalgamating company, or to ensure that the amalgamation is for genuine business purposes.

In the event of the aforesaid specified conditions not being fulfilled, that part of the carry forward of the accumulated losses and the unabsorbed depreciation, remaining to be utilized by the amalgamated company, will be treated as the income in the year in which the failure to fulfil such conditions takes place.

(iii) **Capital Gains Tax:** No capital gains tax applies to the amalgamating company or its shareholders, if they get the shares in the amalgamated company.

(iv) **Other Related Provisions of Taxes**

These are given hereunder as follows:

(a) The amalgamated company is required to pay the taxes, due from the amalgamated company.

(b) (i) Expenses of amalgamation are not treated as tax-deductible expenses.

(ii) However, the taxes on the income of the amalgamated company, paid or even payable, as also the income tax litigation expenses, are treated as tax-deductible expenses for the amalgamated company.

(c) Bad debts, arising out of the debts of the amalgamating company, which were taken over by the amalgamated company, however, are not treated as tax-deductible.

(d) Any refund of taxes, paid by the amalgamating company, will be refunded to the amalgamated company.

(e) Any carried forward long-term capital losses, incurred by the amalgamating company, do not get carried forward by the amalgamated company.

5.5.3 Accounting Systems and Procedures

As per the Accounting Standard 14 (AS14) pertaining to the amalgamation (issued by the Institute of Chartered Accountants of India), an amalgamation may be either in the nature of:

(a) Uniting for interest (or merger), or (b) Acquisition.

Cash vs Stock Compensation

While taking a decision as to whether the payment of the resultant compensation should be made in cash or in stocks (shares of the amalgamated company) to the shareholders of the amalgamating company, the following three main factors must be considered and weighed:

(i) **Overvaluation:** In case the stocks of the acquiring company happen to be overvalued, in comparison to the stocks of the acquired company, it will make a better business sense to pay the compensation in the form of stocks (shares) of the acquiring company, instead of in cash, which may naturally prove to be a cheaper and hence a more profitable proposition.

(ii) **Tax benefits:** While the cash compensation, paid to the shareholders of the acquired company, becomes taxable in their hands, the compensation paid in the form of stocks (shares) is treated as non-taxable. Therefore, it may be beneficial for the shareholders of the acquired company to prefer the compensation in the form of stocks (shares), rather than in cash.

(iii) **Risk and Reward Sharing:** In the case of payment of the compensation in cash, the shareholders of the acquired company automatically get absolved of all the risks but, at the same time, they get deprived of the rewards of the merger, too. As against this, if the compensation was to be paid in the form of stocks (shares), the shareholders of the acquired company continue to share all the risks as also the rewards connected with the merger.

5.6 TAKEOVERS

5.6.1 What Constitutes a Takeover?

A takeover usually comprises acquiring the effective control over the affairs of the company by virtue of holding a substantial amount of value and volume of the shares of the target company. Theoretically speaking, for the purpose of takeovers, the taking over company must acquire at least 51 per cent of the fully paid up equity shares of the target company. But, in actual practice, even from 40 per cent to as little as 20 per cent, or even a lesser percentage, may be found to be quite sufficient to serve the purpose. The aborted attempt, on the part of the Reliance Industries Limited (RIL), to acquire a certain percentage

of the fully paid up shares of L&T from the open market, through some indirect channel, is a case in point.

This is so because, most of the small investors (shareholders) are scattered and unorganized, whereby they just do not have an effective voice and actual voting to thwart any adverse attempt or to change some vital decision of the board of directors of the company, in the general body meeting, called for the purpose. Some of the companies (e.g. RIL) even prefer to strategically hold such general body meetings, or even annual general meetings, in some remote villages located in rather difficult locations, so as to discourage the participation of most of the shareholders, especially those who may be expected to raise some points of objection and differences. However, the pro-management shareholders are facilitated to reach the venue in time, or even well in advance.

Takeovers, however, of late, have gained much popularity in the Indian corporate world. Some prominent cases of recent takeovers are as follows:

Chhabrias	:	Shaw Wallace
Goenkas	:	Calcutta Electric Supply Company (CESCO)
Hindujas	:	Ashok Leyland
Hindalco	:	Indal

Mcleod Russel : Union Carbide (Renamed as Eveready India)

5.6.2 Reasons (for and against) Take Overs

Opinions are widely divided amongst the academia and the professionals about the advantages, or otherwise, of the process of takeovers. It is generally agreed that the takeovers usually lead to a marked improvement, in forward and backward integrations, and the beneficial synergetic effects. Likewise, it has been argued that the imminent dangers of take overs may induce and activate the management to be always on its toes, so as to avoid and avert any such attempt. In fact, T. Boone Pickens, Jr., vehemently argues in favour of take overs and goes to the extent of saying that it is an effective device to punish the weak management, and thereby to protect the interest of the small investors (shareholders). But, on the other hand, Warren Law incisively criticises and challenges the arguments of Pickens, Jr., and holds that the extant management looks after the interest of the company and its shareholders in a much better manner, in comparison to the raiders (or predators), who have generally been seen to take over the companies with a view to making a fast buck, or to serve its own interest at the cost of the other. Peter F Drucker is also opposed to the strategy of take overs, as he feels that it usually adversely affects the morale of the employees, as also the activities of the company. He further strengthens his arguments against take overs by saying that it is only in some 30 per cent cases that some improvements in the performance have been observed. Thus, in a majority of 70 per cent cases, the take overs have failed to bring in any improvement in the efficacy of the management.

ut then, there are sufficient evidences even in support of take overs, s have been revealed by several empirical studies. Michael Jensen and ichard have concluded: 'In brief, the evidence seems to indicate that orporate take overs generate positive gains, that target shareholders enefit and the bidding firm's shareholders do not lose.... Finally, it s difficult to find managerial actions related to corporate control that arm shareholders'.

.6.3 Rules and Regulations of Take Overs

he take overs, to be considered as legal and legitimate, must confirm o the following laid down rules and regulations:

(i) **Transparency in the Process of Take overs:** The process of take overs involves the varied interests of various parties and persons, like the shareholders, employees, customers, suppliers, creditors, the various acquirers, and so on. Hence, it has been provided that the whole process of the take over should be, and should also be perceived to be, open and above board, transparent and clear, such that all the involved parties may feel satisfied that their interest is not jeopardized in any manner, and at any stage.

(ii) **Safeguarding the Interest of the Small Investors:** It has been observed that in the take over process, the 'controlling block' of the shares (which usually ranges between 20 to 40 per cent or so), is acquired from one single party at a negotiated price which, naturally, is higher than the prevailing market price. Implicitly, the single party concerned must have purchased these shares from the open market (stock exchanges) from various parties, largely involving the small shareholders, at the prevailing market price, which is definitely lower than the negotiated (selling) price that the single purchaser must have charged from the acquirer firm. Thus, in the process, the small shareholders stand to lose, if they are not in the know of the deal. Under the aforesaid circumstances, the code of conduct in the process of take overs, should also stipulate that the other shareholders, specially the smaller ones, are not likely to be put at any disadvantageous situation.

(iii) **Realisation of Economic Gains:** The main economic rationale, lying behind any take over, has been stated to be a marked improvement in the efficiency and efficacy of the operations, and a better utilization of the resources. To enable the acquirer to realise such objectives, he must be allowed sufficient flexibility and freedom in the areas of restructuring of the operations, widening the range of the products, deployment of the available resources, etc. Besides, in the cases of take overs of some sick units, with a view to rehabilitating them, the acquirer company must be given some fiscal incentives and concessions, to popularize and accelerate the process of such take overs.

(iv) **Avoidance of Over-concentration of Market Power:** Further, due care must be taken to ensure that, as a result of the take over, the acquirer company may not start enjoying the unduly strong and concentrated power in the market, which has the inherent danger of becoming detrimental to the interest of the customers and others.

(v) **Financial Support:** It has also been suggested that some competent persons, with proven managerial abilities, efficiency and good track records, must be given suitable financial assistance by way of loans from the banking system, or be allowed to approach the investors through capital market, so as to enable them to participate in the take over deal and process, such that it may not remain an exclusive domain of the financially strong and stable companies alone.

5.7 GUIDELINES STIPULATED BY SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

The main guidelines, stipulated and issued by the SEBI, pertaining the acquisition of a substantial portion of the shares of a listed company, are discussed hereunder:

(i) **Notification:** The moment the holding of the acquirer company touches five per cent of the voting share capital of the target company, it is required to immediately inform the target company, as also all the stock exchanges on which the shares are listed and traded.

(ii) **Public Offer:** When such holding of the acquirer exceeds 15 per cent of the voting share capital of the target company, it is required to make a general offer for the purchase of a minimum of 20 per cent of the voting share capital from the remaining share holders, after making a public announcement to this effect.

(iii) **Offer Price:** The offer price can, in no case, be less than the highest of the following:

(a) Negotiated price,

(b) Average price paid by the acquirer,

(c) Preferential offer price, if made during the last twelve months,

(d) Average of the weekly high and low [quoted prices in the stock exchange(s)] for the last twenty-six weeks.

(iv) **Public Announcement:** The public announcement must, inter alia, contain the following information:

(a) Number of shares to be acquired.

(b) Minimum offer price.

(c) Objective of the take over.

(d) Date by which the letter of offer is to be posted.

(e) Opening and closing dates of such offer.

5.7.1 Rationale Behind the SEBI Guidelines

The rationale behind the SEBI guidelines may be said to be as follows:

(i) To provide greater transparency to the deals of the take over.

(ii) To ensure that the disclosures, required to be made, in the public announcements and the letter of offer issued in this regard, are sufficient and adequate, greater and wider.

(iii) To safeguard the interests, specially of the small investors (shareholders).

5.8 ANTI-TAKEOVER DEFENCES IN INDIA

With a view to averting an attempt of a takeover, the Indian companies may invoke one or more of the following anti-takeover defences:

(i) **Make Preferential Allotments:** With a view to enhancing its equity stake, the promoter group may be allotted the required number of the equity shares or convertible securities (like fully convertible debentures) on a preferential basis.

(ii) **Resort to Creeping Enhancement:** SEBI guidelines have provided that the promoter group, can enhance its holding of the equity shares by way of creeping enhancements, within the prescribed limits, without being required to make an offer in the open market.

(iii) **Amalgamation of Group Companies:** A much larger company may be formed by way of amalgamation of two or more of the companies, promoted by the same group(s). This way, the take over may become rather far more difficult, inasmuch as, a larger company is far less vulnerable to the risks of take over, as compared to the smaller ones.

(iv) **Sale of the Crown Jewel:** It has often been found that some particular and valuable assets or assets of the company may attract some other companies to take it over. In such an eventually, the target company prefers to sell off its asset or assets to another company, so as to make it far less attractive in the eyes of the raiders, and thereby avert the attempt of the take over.

Help from a White Knight: A company, under the threat and danger of its takeover, may call for help and support from its friends and supporters. That is to say that, it may request the white knight to help it and save it from the clutches of the raider. The term 'white knight' has been described in the Chambers twenty-first century dictionary, as 'someone who rescues a company financially, especially from an unwanted take-over bid'.

5.9 ROLE OF FINANCIAL INSTITUTIONS

By virtue of holding a substantial portion of the equity shares of large scale industries, the financial institutions command the balance of power,

in that no takeover may take place without their consent. Accordingly, the are expected to play a crucial role in averting any undesirable takeove attempt. It has been found that, while in some cases the financial institutio play the role in an objective and responsible manner, in some other case they seem to play their role in a somewhat arbitrary and undesirabl way. It will, therefore, be much desirable if some general guidelines ar issued, so as to direct the action and role of the financial institutes i the desired manner, and more importantly, in the larger public interest Accordingly, they should ensure that:

(i) The take over process is transparent.

(ii) The prospective acquirer companies are allowed to play on an eve field.

(iii) The likely outcome of the take over should be the improved performanc and profitability of the company concerned.

(iv) The interests of the shareholders, as also those of the other stakeholder and interested parties, stand protected.

(v) The take over may not give rise to any undue concentration of marke power.

5.10 JOINT VENTURES

Joint ventures, or strategic alliances as these are usually referred to involve a partnership between two or more independent companies, whic may join together with common and mutually advantageous purposes It is usually established as a newly constituted company, though th partners concerned may prefer some other form of the organisation. Th establishment of P&G Godrej Limited, a joint venture of Godrej Soa Limited, and Procter and Gamble India Limited, is an apt example i point. In almost all the cases of joint ventures, the partners participate i its equity share capital. They also contribute the resources in the form o technology, facilities channels and network of distribution, brand equity key manpower, etc. Thus, they jointly manage and control the affairs o the joint venture.

5.10.1 Rationale behind Joint Ventures

In India, the formation of joint ventures, especially between some Indian and foreign company, has, of late, been gaining ground.

The rationales behind such joint enterprises are the following:

(i) To become complementary and supplementary to each others, by pooling together their specific resources for the common purpose.

(ii) To get an access to the supply of raw materials and/or gain grounds in the fresh markets.

(iii) To diversify the components of risks.

(iv) To reap the benefits of the economy of scale.

(v) To ensure cost reduction.

(vi) To enhance the scope of tax concessions and rebate.

But it has also been found (vide the studies conducted by McKinsey & Company, and Cooper & Lybrand), that in most of the cases the joint venture have failed to succeed mainly due to the following reasons:

(i) Inadequate pre-planning.

(ii) Failure in developing the expected technology.

(iii) Differences in the strategy, approach and vision of the partners.

(iv) Reluctance and refusal on the part of the partners to share the control of the management of the company.

(v) Inability to arrive at an agreement in respect of some difficult but vital issues.

It will, therefore auger well if due care is taken to avoid the aforesaid dangers and pitfalls, before attempting to go in for a joint venture company.

5.11 PORTFOLIO RESTRUCTURING

While the mergers, acquisitions, and takeovers are based on the principle of synergy, which may be represented figuratively as 2 + 2 = 5, the portfolio restructuring or demerger can well be termed as 5 – 3 = 3, or on the principle of 'anergy'. These two may as well be said to contain the elements of expansion and contraction, respectively.

5.11.1 Divestitures (Dis-investments)

Divestiture involves the sale, not of the whole but only a part (a division, a plant or a unit) of one company to another. It thus, amounts to expansion and contraction from the respective points of view of the buyer and the seller companies. We may also say that divestiture is the reverse or opposite of purchase. The sale of its cement division by the Coromandel Fertilisers Limited to the India Cements Limited is a case in point. Further, the sale of the cement segment by L & T to Ultratech Cement is a more recent example.

Rationale behind Divestitures

Some of the rationales, lying behind adopting the strategy of divestitures, are discussed hereunder:

(i) **Raising Capital:** Companies, confronted with the problems of cash crunch or lack of liquidity, usually resort to the strategy of divestiture, whereby the inflow of cash could be used for repayments of the debts and settlements of the dues, and the production of the remaining products could be concentrated upon.

CEAT had sold out its nylon tyre chord plant at Gwalior to SRF, fo a consideration of ₹ 325 crore, to meet its aforesaid objectives, and t concentrate on the activities of production of tyres.

(ii) **Reduction of Losses:** When a unit of a company seems to b incurring losses, or even some sub-optimal rate of return, it ma make a better business sense to sell this division or unit to som other interested party, so as to cut its losses, and thereby enhanc its prospects to earn a relatively better profit.

(iii) **Strategic Realignment:** There may be cases where some unit o units of a company may not gel well with its other lines of activities which in turn, may take a lot of its managerial time and energy incommensurate with the revenue and profit generated thereby Under such circumstances, the company may prefer to sell such uni or units to some other interested buyer, so as to concentrate on it main and corelated lines of business for a better overall results.

The case of ICI is a good illustrative example in point. ICI had sol its fibre division to Terene Fibres India, its fertiliser division t Chand Chhap Fertilisers and Chemicals, and its seeds division t Hysum India, mainly for the aforesaid strategic reasons. This ha helped the ICI to concentrate on its main activities of productio of paints and industrial chemicals, which is very much in line wit its parent's line of business and global presence.

(iv) **Enhancement of Efficiency:** It makes a prudent business sense t divest, when the division, plant or unit of the firm is expected t enhance the efficiency, and hence the value, of the part so divested when it becomes a part of the other company, or else, as a independent (stand-alone) business entity. This may happen whe the 'anergy' (also known as the reverse synergy) takes place. Thi may be said to be a situation where the value of the parts become greater than the value of the whole, or else, figuratively speaking when $5 - 3 = 3$ (and not just 2). As against divestitures, the case of mergers, result in synergy, where the whole is expected to be o a greater value than the sum of the parts. This, when represented figuratively, may be stated as $2 + 2 = 5$ or $2 + 3 = 6$.

5.12 FINANCIAL RESTRUCTURING

Financial restructuring, as the name itself suggests, essentially involves a major change in the overall financial structure (composition, base, or source) of a company, and/or the pattern of its ownership and control. It may take place in several ways. But, the main two types of financial restructuring have been discussed here. These are:

- Financial restructuring, with a view to bringing some relief from the debt burden

- Financial restructuring, with a view to concentrating the ownership of the equity shares of the company (and the management and control therewith) in a few hands only, with the financial help from the outside by way of debt, instead of equity.

5.12.1 Relief from Debt Burden

The companies, confronted with some financial difficulties, or those which are already sick or are about to be declared sick, endeavour to significantly and substantially reduce the quantum and extent of the burden in the form of debt, in one or more of the following ways:

(i) They request their creditors (lenders) to convert the entire portion, or a substantial portion, of the debt into equity, whereby the burden of ever increasing payment of interest on account of debt, could be avoided. As we all know, as against the legal obligation, on the part of the company, to regularly make the payment of the amount of periodical interest on debt or debentures, there is no compulsion on its part to pay any dividend on its equity shares.

(ii) They may as well request the creditors for the writing off of a substantial portion, or the entire quantum of interest, accumulated over a period of time.

(iii) The third strategy that they may adopt is to make a request for the provision of a suitable moratorium on the repayment schedule of the loans, both short-term and long-term.

(iv) They may also request for a suitable reduction in the rate of interest being charged from them on their loan accounts.

(v) Further, they may as well request for the concessions to the following effects:

(a) That, the accumulated quantum of interest may be made payable by them in suitable instalments, commensurate with their income generation, as from now, and

(b) That, they may not be required to pay any interest on the amount of the entire accumulated interest.

5.13 CONCENTRATED EQUITY WITH DEBT COMPONENTS (ALSO KNOWN AS LEVERAGED BUYOUT)

The idea behind keeping the entire equity shares of the company within a very limited number of shareholders is to keep the management and overall control of the company in rather personal pockets. To this end, the balance amount of the finance required, being of a very high percentage, usually in the range of 80 to 85 per cent, is met by the outside sources, but only by way of debts, and not as equity. This strategy serves the

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twin purposes, of keeping the management and control of the company exclusively in very limited hands and, at the same time, keeping the owners' stake in the business to a limited extent.

Besides, the very fact that a very large portion of such venture is financed by way of a debt, it may go a long way in strengthening and streamlining the management of the company in an efficient and professional manner, so as to service the debt in due time. This brooks no mistake on the part of the management, which is required to be on its toes all the time. As G. Bennett Stewart III, Succinefly puts: Equity is soft, debt hard: Equity is forgiving, debt insistent; equity is a pillow, debt a sword. Equity and debt are the yin and yang of corporate finance.

[*Yin and Yang, in the Chinese language, stand for feminine and masculine elements, force and energy*]

Such arrangement, in the parlance and jargon of financial management, is referred to as 'Leveraged Buyouts'. Usually, such leveraged buyouts pertain to the acquisition of a division or unit of a company, and rarely by way of the purchase of the company, as a whole. The steps and strategies, involved in a leveraged buyout transaction, may be better understood and comprehended with the help of an illustrative example.

Example

Sunrise Industries Limited has five divisions, viz. plastic, paper, printing, leather bags, and home-appliances divisions. The company does not seem to be doing very well in its printing division. Accordingly, it is contemplating to sell this division out. But, unfortunately, it is expected to fetch only ₹ 100 lakh on liquidation, though its replacement cost has been estimated at ₹ 175 lakh. But, the company seems to be inclined to sell the division just for ₹ 120 lakh. Five key personnel in the printing division are reported to be inclined to purchase the printing division for ₹ 120 lakh, on a leverage buyout basis. But, they are prepared to invest ₹ 10 lakh only; all of the five persons contributing ₹ 2 lakh each. They now go to the financial institution for grant of a term loan to finance the project. On appraisal of the project report, submitted by the five executives, the financial institution has to come to the conclusion that the new company, run on an independent basis, by the five key personnel of the erstwhile printing division, may be able to generate sufficient cash surplus to support a total outlay of ₹ 120 lakh. But, the financial institution has assessed the quantum of term loan at ₹ 100 lakh only. This still leaves a gap of ₹ 10 lakh. Now the new proposed company contacts a private investor, who is willing to invest a sum of ₹ 10 lakh in the company by way of its equity shares. Thus finally, the printing division of the company gets incorporated under the name of 'Popular Printing Press' as an independent company, with the capital base detailed as follows:

(i)	Equity shares of ₹ 2 lakh each by the five key personnel of the erstwhile printing division of the Sunrise Industries Limited	₹ 10 lakh
(ii)	Equity shares of an outsider (the private investor)	₹ 10 lakh
(iii)	Term loan by the Financial Institution	₹ 100 lakh
	Total	₹ 120 lakh

Thus, the loan fund is ₹ 100 lakh, and the equity base is ₹ 20 lakh only, in the ratio of 5:1, or say, 83 per cent and 17 per cent (approximately).

A Success Story

Kohlberg Kravis Robert & Co. (KKRC), has acquired a major portion of the equity shares in a large number of companies, like RJR (the tobacco giant), Safeway (a large chain of grocery shops), Owen-Illinois (the largest glass manufacturing company in the USA), and Duracell (a reputed company manufacturing batteries), to name only a few. Thus, we see that all the forenamed companies, acquired by KKRC, are entirely unrelated to each other. Further, the company had paid quite a high premium for such deals. The company, however, has been reported to have had a mixed record of success, and some failures, too.

It may, therefore, augur well for the business world to learn a lesson or two from the facilitating factors, the steps and strategies, that have gone to improve and enhance the productivity and profitability of the majority of the companies, after these had been acquired by KKRC. Some of such outstanding success factors are discussed hereafter.

Decentralized Structure

The company has taken a strategic stand in favour of having a thoroughly decentralized organizational structure, in the truest sense of the term. Accordingly, all the companies have a minimal number of staff. It does not have the usual bureaucratic managerial culture in the organisations. There is no setting of corporate goals of productivity and overheads, nor holding of any corporate meetings. Above all, the company has realised that its people are its most important asset. Therefore, KKRC manages people, not by mandate, but by motivation. It works, and works well. Because, as we all know, we may force people to work, but cannot force people to work well. You can only motivate them to work well, as the motivated people work, not because they have to, but because they love to.

Aggressive Use of Debt

Though KKRC largely depends on the debt component in its capital structure, all its borrowings are also completely decentralised. Besides, the loans are obtained, managed and served by the subsidiary companies independently, and effectively. To put it in the words of G. Bennett Stewart III 'Much like a boat whose hull is divided into separate chambers; compartmentalising debt and equity ensures that a leak in any one unit cannot sink the equity in any of the other unit'.

(Source: 'The Quest for Value', Harper Business, New York, 1991).

Prompt Repayment of Debts

KKRC believes in the principle of repaying the amount of instalments, with interest, as soon as possible, and preferably, even much earlier than the stipulated due dates, as per the repayment schedule. It thus, saves a substantial amount of interest payable on the loans. Further, by virtue of such earlier repayment practices, the credit-worthiness and financial stability and viability of the company go further higher up in the eyes of the banks and the other creditors. This way, the company's borrowing capacity and credibility gets greatly enhanced which, in turn, facilitates the sanction and disbursement of further chains of loans to the company by the banks and the other creditors. Finally, the company may as well gradually enhance its ownership stake in the business, and reduce its dependability on debts.

5.14 ORGANISATIONAL RESTRUCTURING

In the present era of globalization, and the resultant ever-increasing competition, most of the companies have now preferred to adopt the strategy of organizational restructuring. Some of the main and common elements and strategies involved in the organizational restructuring have been discussed hereafter.

Regrouping

This strategy involves the regrouping of a bigger number of scattered groups into a smaller number of groups; comprising strategically compact business units. Such groups/units are usually known as 'profit centres'. Based on such strategic principle, the renowned consulting firm McKinsey had recommended to Larsen and Toubro (L&T) to regroup its twelve business units into just five compact units or divisions. State Bank of India, too, on the advice of McKinsey, had created just four focused business groups, viz. Corporate, National Banking, International Banking, and Associates and Subsidiaries.

Decentralization

De-centralization and delayering gives extensive and enhanced discretionary powers to the executives, go a long way in facilitating much quicker decision-making process, and the financial gains that go therewith. This strategy empowers people and enhances their level of motivation, zeal and commitment. McKensey had made such suggestions to the State Bank of India, which has resulted in perceptible change in the pace and speed in the decision-making process. Hindustan Lever Limited, too, has reduced its managerial layers from nine to five.

[The name of Hindustan Lever Limited has since been changed to Unilever India Limited].

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Downsizing

Downsizing, since being more elegantly and respectfully referred to as rightsizing instead, involves reducing the size of the workforce, both at the clerical (and worker's) and officers' levels, so as to keep the amount of payment of salary and wages at the minimal possible extent, with a view to cutting down the surplus manpower upto an optimal level. The strategy of introducing and implementing the Voluntary Retirement Scheme (VRS) has been found to be most popular in the recent times. Accordingly, the Tata Iron and Steel Company (now Tata Steel) had resorted to the downsizing strategy in a big way in the late 1990s, and so had been the case with the State Bank of India (SBI) in 2001–2002.

Outsourcing

Outsourcing means that the non-value adding activities may better be done from some outside sources, instead of doing it in-house. It also involves sub-contracting. Such strategies keep the fixed costs at a very low level, and the break-even point too, therewith. Thus, the entire cost of outsourcing and sub-contracting comprises just the variable cost. It is with such beneficial fallouts that the Tata Engineering and Locomotive Company (now Tata Motors) preferred to procure around 75 per cent of the parts and components for its Indica car by way of outsourcing and/or sub-contracting.

Business Process Re-engineering (BPR)

According to Joe Peppard and Philip Rowland, the Business Process Re-engineering (BPR) 'aims to achieve improvement in performance by re-designing the process, through which an organisation operates, maximizing their value-added content and maximizing everything else. This approach can be applied to an individual process level, or to the whole organization'. A very handy example of BPR is the case of re-engineering of Ford Motor Company's accounts payable (sundry debtors) department, which had resulted in the manpower reduction to a substantial extent, that is, up to 75 per cent.

Computerized Management Information System (MIS)

In the present age of high-tech and computerization of business activities, the traditional MIS is gradually being replaced with the computer-based MIS, whereby, instead of fragmented and departmentalised MIS, the whole enterprise-wide computerized and integrated MIS has been evolved. This mechanization helps the management to quickly perceive and foresee the overall effect and ramifications that a change in one segment or division may have on the performance and activities of the entire organization. This is one of the several beneficial uses of the advancement in the Information Technology (IT) in the area of planning,

management and control. The computerbased MIS is popularly referred to as the comprehensive enterprise resource planning system. Mahindra and Mahindra (M&M) is one of the companies, which has introduced such system in its organization.

Total Quality Management (TQM)

Total Quality Management (TQM) has proved to be a very effective instrument of quality control which, in turn, goes a long way in reducing the cost, enhancing the customer satisfaction as also the loyalty to the product, and the productivity and profitability of the company that go therewith. Accordingly, the obtention of quality certificates and registrations like ISO 9000, ISO 9002, and so on, are gradually gaining popularity in the various industrial and commercial segments in India. Such certifications and registrations have been found to be a great motivating factor for the much-desired zeal to improve upon the quality of the products on an on-going basis. The introduction and implementation of a very ambitious Six Sigma Total Quality Management (TQM) drive by WIPRO is a recent case in point.

5.15 FINANCIAL EVALUATION OF DIVESTITURE

In the event of the sale of a unit (a division or a plant) by one company to another, both the assets and liabilities of the unit get transferred to the buyer company, of course, with the consent of the creditors concerned. That is to say that, the selling company (hereafter referred to as the parent company) essentially transfers its ownership rights and portion in that specific unit so divested.

It, therefore, means a prudent business sense to first evaluate whether such proposed and planned divestiture will be financially gainful and therefore, desirable. While undertaking such excercise of the financial evaluation, the following steps and procedures must be adopted, as has been discussed seriatim hereafter.

Estimate the Post-tax Cash Flow of the Unit (or Division or Plant)

Such estimate essentially aims at evaluating as to what may happen, in regard to the post-tax cash flow of the parent company in the following two cases:

(i) With the unit (or division), and

(ii) Without the unit (or division).

Thus, the difference between the two will represent the post-tax cash flow that may be attributed to the unit (or division) being so divested.

Compute the Discount Rate of the Unit (or the Division)

The discount rate applicable to the post-tax cash flow of the unit (or the division) must represent the risk of such unit (or division) as a separate

business entity (a stand alone business unit). How to go about computing it? One of the approaches, suggested in such cases, is to first find out the cost of capital of some company (or a group of companies) which are solely or substantially engaged in the same line of business, and which are operating on almost the same scale and size. Thereafter, by proxy, use this as the estimated cost of capital of the unit (or the division).

Compute the Present Value of the Unit (Division)

Use the discount rate, estimated in Step 2 above, and compute the present value of the post-tax cash flow estimated in step 1 above. This will represent the current worth or the present value of the capability of the unit (or division) to generate the cash flow.

Estimate the Market Value of the Liabilities Pertaining Exclusively to the Unit (Division) being so Divested.

The market value of the unit (division) being divested is nothing but the present value of the obligations pertaining to the liabilities of such unit or division. It must, however, be noted that the market value of the liabilities, exclusively of the unit or division, will be quite different from its book value, if the contracted rates of interest on such liabilities are different from the current rates of interest.

Find out the Value of the Position of Ownership of the Parent Company in this Unit (or Division)

The value of the ownership position (VOP) of the parent company can well be computed in the following manner: Present value of the cash flow of the unit or division (vide Step 3 above) [less] the market value of the unit specific (or division specific) liabilities.

Compare the Value of the Ownership Position (VOP) with the Divestiture Proceeds (DP)

Now comes the final stage, when the decision has to be taken for or against the adoption of the strategy of divestiture. Here, the rule of the decision is simple enough. That is:

(a) If the divestiture proceeds (DP) are greater than the value of the ownership position (VOP) of the parent company, the natural decision will be go for the sale of the unit or division.

(b) As against this, if DP is less than the VOP, one must not sell the unit (or division) but retain it, instead.

(c) If both DP and VOP happen to be equal (or almost equal) the decision could be taken either way.

5.16 GUIDELINES FOR MANAGING DIVESTMENTS

It will augur well for the corporate world to develop and follow some basic guidelines and ground rules for taking the strategic decision of disinvestments (divestitures).

Normal Part of the Business Life

As rightly puts it, 'a company lives by expanding and contracting, by growing and changing, by acquiring and divesting. These are the actions of a healthy, vital company, not a sick, dying company'. Thus, the process of disinvestments must be treated as a normal process of change and growth. As we know, the various business and industrial activities have their own life cycles of ups and downs. A business activity, considered most appealing and attractive today, may take a back seat tomorrow, and *vice versa*. Sometimes we may tend to take some wrong decisions, unwittingly. Therefore, there is no harm in rectifying such mistakes at a later stage, sooner the better.

Only One Out of Many Responses

In case a business or division starts showing some signs of under-performance, a large number of options and strategies are available to us to face such adverse situations. We may prefer to wait and watch for sometime and allow the activity to continue for some more time. Or else, we may keep it closed down for some time, till the business conditions improve favourably, and for the better. The third option could be to add some new product lines to make the venture viable. The strategy of taking effective and aggressive measures to control the cost, so as to sell the product(s) at a comparatively lower price could as well be a prudent and paying strategy. The expansion and strengthening of the manufacturing, marketing and/or distribution activities could also resolve the problem to a great extent. Further, when none of the aforesaid steps and strategies seems to be working to give the desired results, the strategy of disinvestments needs to be considered and reconsidered with great seriousness.

Positive Approach

The main management *mantra* in the business world is that the event of disinvestments must be viewed most positively – as an opportunity and not as a malady or catastrophe. We must always bear in mind the words of Leonard Vignola Jr., as he rightly says 'Difficulties abound and optimum divestment is not overly easy to accomplish. Yet divestment ought to be viewed as a chance to turn a less than favourable situation into a future benefit to the divesting company'.

SUMMARY

- Merger and acquisition involve merger itself, or the purchase of a division, or take overs, or joint ventures. Corporate restructuring, however, comprises portfolio restructuring, financial restructuring and organisational restructuring. Merger involves a combination of

two companies together: the one merging with the other, and a new company emerging.

- **Types of Mergers:**
  (i) *Horizontal*: Merger of the companies engaged in the same line of business.
  (ii) *Vertical*: Amalgamation of the firms, engaged in different stages of production of the same product.
  (iii) *Conglomerate*: Merger of companies engaged in unrelated lines of activities.
- **Take overs:** A take over usually comprises acquiring effective control over the affairs of the company by virtue of holding a substantial amount of value and volume of the shares of the target company. Theoretically speaking, the taking over company must acquire at least 51 per cent of the fully paid up equity shares of the target company. But, in actual practice, even 40 per cent to 20 per cent, or even lesser percentage, serve the purpose, because most of the small investors (shareholders) are scattered and unorganized.
- **Joint Ventures:** Joint ventures, or strategic alliances, involve a partnership between two or more independent companies, joining together with common and mutually advantageous purposes. Here, the partners participate in its equity share capital. They also contribute the resources in the form of technology, facilities channels and network of distribution, brand equity, key manpower, and so on. Further, they jointly manage and control the affairs of the joint venture.
- **Portfolio Restructuring:** While the mergers, acquisitions and takeovers are based on the principle of synergy, which may be represented figuratively as 2 + 2 = 5, the portfolio restructuring or demerger can well be termed as 5 – 3 = 3, or on the principle of 'anergy', involving expansion and contraction, respectively.
- **Financial Restructuring:** It involves a major change in the overall financial structure (composition, base, or source) of a company, and/or the pattern of its ownership and control. The financial restructuring generally takes place with a view to:
  (i) Bringing some relief from the debt burden, and
  (ii) Concentrating the ownership of the equity shares of the company (and the management and control therewith) in a few hands only, with the financial help from outside by way of debt, instead of equity.

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REVIEW QUESTIONS

1. What are the various reasonable and unreasonable rationales involved in mergers? Explain each of them separately.
2. What are the various types of mergers? Explain each of them separately.
3. Merger transactions involve three main considerations, viz. legal procedures, tax provisions, and accounting systems and procedures. Explain each of them separately.
4. Discuss the salient features of a takeover.
5. Opinions are widely divided in the academic and the professional world about the advantages, or otherwise, of the process of takeovers. Elucidate.
6. (i) What are the main guidelines stipulated and issued by the Securities and Exchange Board of India (SEBI), pertaining to the acquisition of a substantial portion of the shares of a listed company?
   (ii) What is the rationale behind each of the SEBI guidelines?
7. What are the salient features of Joint Ventures? What is the rationales behind such joint enterprises?
8. While mergers, acquisitions, and takeovers are based on the principle of synergy, the demergers are based on the principle of 'anergy'. Elucidate.
9. What are the main elements and strategies involved in the organizational restructuring?

UNIT 6 STAFFING—RECRUITMENT

NOTES

★ STRUCTURE ★

6.1 Introduction
6.2 The Recruitment Process
6.3 Sources of Recruitment
6.4 Methods of Recruitment
6.5 Recruitment Scenario In India
- Summary
- Review Questions

6.1 INTRODUCTION

Staffing is the processing of obtaining and maintaining capable and competent people to fill all the positions from the top management to operative level. This includes securing, recruting, selecting, training, appraising and maintaining the individuals in organisations.

Recruitment is a linking activity that brings together those with jobs to fill and those seeking jobs. It is the process by which organisations identify and attract individuals to fill job vacancies. The basic purpose of recruiting is to develop a group of potentially qualified people. To this end, the organisation must communicate the position in such a way that job seekers respond. To be cost effective, the recruitment process should attract qualified applicants and provide enough information for unqualified persons to stay out of the reckoning. There are two popular theories of recruitment, which require close attention at this stage:

- *Prospecting theory:* Recruitment is the process of locating and encouraging potential applicants to apply for existing or anticipated job openings. The firm informs the job market about possible vacancies and encourages qualified applicants to apply (popularly known as the prospecting theory of recruitment).
- *Mating theory:* Recruitment is actually a two-way traffic. It is a linking function, joining together those with jobs to fill and those seeking jobs. According to this view, the firm's announcement of a possible opening will not get a good response when people with requisite qualifications do not show any interest or have a genuine requirement for switching a job. The best results in recruitment would come only when there is a 'fit' between organisational recruitment efforts

and a candidate's job search efforts. Whichever way you look at it, recruitment means finding and/or attracting a fairly large number of well-qualified applicants for the employer's open positions.

Features: The key features of recruitment include the following:

- *Locating and attracting talent:* Recruiting is the process of locating and attracting qualified people to fill job vacancies.
- *Linking process:* It links job seekers with employers wanting to fill vacancies in their organisations.
- *Positive process of building a talent pool:* Recruiting aims at building a pool of well qualified applicants. It seeks a fairly large pool of applicants so that the recruiter has a choice.
- *Vital function:* Every organisation, small or big, undertakes recruitment, a vital function without which no organisation can get qualified people to accomplish its objectives. In a knowledge-based technology-driven economy, every recruiter is compelled to go that extra mile in order to get people possessing requisite qualifications.

6.2 THE RECRUITMENT PROCESS

The recruitment process is meant to ensure adequate supply of reasonably qualified applicants for a vacant position. The emphasis, it must be remembered here, is not on quantity. If the process generates a sea of unqualified applicants, the organisation will waste lot of time and money in the screening activity. And you may miss the bus even due to non availability of talent matching requirement. The recruitment process is meant to identify possible sources of supply and attract reasonably good number of responses from people who possess the skills that the organisation requires and who are willing to accept the job offer when selected. In order to achieve this, the following steps must be put in place in a sequential form:

1. ***Identify the required numbers and the sources of supply:*** After identifying the number of vacancies to be filled up, the HR department identifies the number and type of employees needed and the possible sources of supply (for example, an educational institution or a specific region like Bangalore, where software professionals are easily available, or from the open market or look for qualified people on a global scale).
2. ***Publicize job details:*** The company needs to give detailed information about the job opportunity, growth prospects, compensation details and other conditions of service. If the attempt is to hire people from a rival company, the whole exercise can be carried out through professional recruiting agencies that volunteer to get the right person for the job quickly.
3. ***Encouraging prospective job seekers to apply in large numbers:*** In order to save time and resources in screening and short listing

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the candidates, the recruiter company must encourage only qualified people to apply for the job vacancies. Recruiting effort, to be effective, must always be directed towards qualified applicants (like only those who have completed CA in the first attempt need apply for a vacancy) possessing relevant qualifications (say, having a degree in law is desirable) experience (say with exposure to IT industry) and having a right mental attitude (say, ready to move to any location without any preconditions).

4. ***Evaluating recruiting effort:*** It is better to evaluate the recruiting effort after filling up vacancies with a view to finding out whether the company is able to meet the recruiting criteria. The evaluation process would certainly help companies to learn from past mistakes and suitably modify their methods (like not visiting a campus that did not offer good quality students, not limiting the search to Bangalore while looking for qualified software professionals for a crucial position, etc).

6.3 SOURCES OF RECRUITMENT

The sources of recruitment may be broadly divided into two categories: internal sources and external sources. Organisations like General Electric, United Parcel Service, give lot of importance to developing and promoting managers within the firm. Grooming talent from within is also a much-publicized path chosen by Larsen & Toubro, ITC, HLL etc in India. Both have their own merits and demerits. Let's examine these.

1. ***Internal sources:*** Persons who are already working in an organisation constitute the 'internal sources'. Retrenched employees, retired employees and dependents of deceased employees may also constitute the internal sources. Whenever any vacancy arises, someone from within the organisation is upgraded, transferred, promoted or even demoted.
2. ***External sources:*** External sources are (*a*) employees working in other organisations; (*b*) job aspirants registered with employment exchanges; (*c*) students from reputed educational institutions; (*d*) candidates referred by unions, friends, relatives and existing employees; (*e*) candidates forwarded by search firms and contractors; (*f*) candidates responding to the advertisements, issued by the organisation; and (*g*) unsolicited applications/walk-ins. The merits and demerits of recruiting candidates from outside an organisation may be listed as follows.

Merits: External sources offer a wide choice and enable the injection of fresh blood into the organisation. Internal candidates may have to fight with external candidates while trying to slip into positions of their choice. They are, thus, forced to work harder and smarter in order to realise their career-related goals. Talented people gaining entry into the organisation

based on merit, skills, knowledge and experience is always a sign of good corporate governance. Organisations benefit immensely when capable people are available to handle challenging assignments readily.

Demerits: External sources are quite expensive and the cost might prove to be prohibitive at times. It takes more time and effort to find to the right candidate and unless the organisation is prepared to go that extra mile, candidates possessing the requisite skills and knowledge are not readily found. It is particularly demotivating to people who have remained within the organisation for a long time and are not being considered favorably for possible vacancies that have some prestige value. Finally, there is no guarantee that candidates hired from outside would fit in with the culture and get along with rest of the people in an amicable fashion. It would be risky to allow misfits to continue, and for any reason if they were shown the door, it would send wrong signals in the market. So, every recruiter has to walk the fine line and strike a harmonious balance between internal sources and external sources while trying to fill up possible vacancies arising from time to time.

6.4 METHODS OF RECRUITMENT

Recruitment sources are where qualified candidates are located such as Colleges, Universities or competitors. Recruitment methods are the specific means used to attract potential employees to the firm. As indicated above, a firm can recruit people internally or externally. The process of seeking job applicants with the company is known as internal recruiting. The process of seeking job applicants from outside the organisation using activities such as advertisements, job fairs and the internet is known as external recruiting.

Methods of Recruitment

Internal Methods	External Methods
• Promotions and transfers	• Campus recruitment
• Job posting and job bidding	• Advertising
• Employee referrals	• Employment search firms
	• Employment exchanges
	• Gate hiring, Contractors and Temp Agencies
	• Unsolicited applicants
	• Internet recruiting
	• Job fairs

Internal Methods

1. ***Promotions and transfers:*** Many organisations prefer to fill vacancies through promotions or transfers from within wherever possible.

Promotion involves movement of an employee from a lower level position to a higher level position accompanied by (usually) changes in duties, responsibilities, status and value. The Tatas, the Birlas and most multinationals (e.g. HLL's Lister programme tracking star performers at an early stage and offering stimulating opportunities to grow vertically) have fast-track promotion systems in place. The credo now is reward performance, but promote competency. In the recent past, the AV Birla group has placed over 200 people through the fast-tracker system (promoting star performers quickly). A transfer, on the other hand, involves lateral movement within the same grade, from one job to another. It may lead to changes in duties and responsibilities, working conditions, etc., but not necessarily salary. Internal promotions and transfers certainly allow people greater scope to experiment with their careers, kindling ambitions and motivating them to take a shot at something they might otherwise never have considered. The system, of course, works best for young executives who are willing to take risks.

2. ***Job posting and job bidding:*** Job posting is another way of hiring people from within. In this method, the organisation publicizes job openings on bulletin boards, electronic media and similar outlets. Most software firms typically rely on intranet or the internet for informing employees that job openings exist. Job bidding is a procedure that allows employees who believe that they possess the required qualifications to apply for a posted job. Hindustan Lever introduced its version of open job postings in early 2002 and quite a sizeable number of positions have since been filled through the process. HLL even allows its employees to undertake career shifts, for example from technical positions to non-technical jobs such as marketing, market research etc., through the open job posting system. Likewise, when Kotak Securities was hit hard by the bear market during 2008, the excess staff were shifted to Kotak Mahindra Bank which had openings in branch banking and credit card business. The AV Birla group allows its employees an opportunity to apply not just for jobs within their own companies, but for jobs in any company in the Birla group both in India and abroad. *(Business Today and Business World, Best Employer survey and Best Places to work survey 2008, 2009, 2013)*

   This method offers a chance to eligible candidates working within a company to grow internally. Such opportunities create the occasional excitement required to cheer up people. It encourages managers to discuss career openings with employees and makes people realise the need for enhancing career-focused skills and knowledge. The procedure reflects an openness that most employees would welcome. It motivates employees by showing that hard work and performance can result in promotion. Internal job postings, finally, are relatively fast and very inexpensive to use. Care should be taken, however, to fill vacant positions with qualified people. If not, the method will get

crushed by the weight of truckloads of complaints from people who are qualified but left out because of unfair treatment. Unsuccessful applicants must need to be informed about why they could not make it. If the trust and confidence between eligible candidates and the management breaks down, employees might revolt violently and morale-related problems may vitiate campus life in a major way.

3. ***Employee referrals:*** Employee referral (also known as word of mouth advertising) means using personal contacts to locate job opportunities. It is a recommendation from a current employee regarding a job applicant. The logic behind employee referral is that 'it takes one to know one'. Employees working in the organisation, in this case, are encouraged to recommend the names of their friends working in other organisations for a possible vacancy in the near future. In fact, this has become a popular way of recruiting people in the highly competitive Information Technology industry nowadays. Companies offer rich rewards also to employees whose recommendations are accepted – after the routine screening and examining process is over – and job offers extended to the suggested candidates. Citibank, for example, offers ₹ 50,000 to its employees for every vacancy filled up by the bank on the basis of their referral. Adobe India runs a referral scheme where all employees who have successfully referred a candidate are eligible for a lucky draw where they can win a luxury car. Birla 3M also has an incentive-based employee referral programme in place. Infotech companies such as Polaris Software Labs, Cognizant Technology Solutions, Cisco Systems, etc., have even discovered that the stickiness of employees joining through referral scheme is quite high. Companies like Intel, IBM, Cisco, Flextronics encourage employees to refer their friends and acquaintances regularly and win referral bonus, on the spot cash awards, get entitled to a lucky draw(in addition to the above). Modern companies also use what is popularly known as Employee Enlistment. It is a unique form of employee referral where every employee becomes a company recruiter. This is not merely asking existing employees to refer their friends to the company. The firm supplies employees with business cards that do not reveal names or positions. They simply contain a message "We are looking for – For additional information log on to our Web site." Employees are encouraged to distribute these cards wherever they go, such as parties, picnics, family gatherings, sports events, community gatherings etc. The underlying philosophy is to let everyone know that the company wants qualified people to apply immediately (see Mondy).

   To obtain effective results, the details of a referral scheme should percolate down to all levels using various means such as posters, e-mails, kick off parties etc. Employees should understand that they are being entrusted with a critical task. And those making a referral should get prompt feedback so that they come back with

more referrals. An upper limit for the number of referrals and the rewards to be doled out could be fixed in advance to avoid any disappointment in this regard later on. Every attempt however should be made to ensure quality. The firm should constantly measure the quality and performance of employees recruited through the programme. Finally, when the firm decides to shut down the programme, it should give advance notice and clearly communicate the reason for doing so.

External Methods

4. ***Campus recruitment:*** It is a method of recruiting by visiting and participating in college campuses and their placement centres. Here, the recruiters visit reputed educational institutions such as IITs, IIMs, colleges and universities with a view to identifying job aspirants having requisite technical or professional skills. Job seekers are provided information about the jobs, and the recruiters, in turn, get a snapshot of job seekers through constant interchange of information with respective institutions. A preliminary screening is done within the campus and the shortlisted students are then subjected to the remainder of the selection process.

   In view of the growing demand for young managers, most reputed organisations (such as Hindustan Lever Ltd, Proctor & Gamble, Citibank, State Bank of India, Tata and Birla group companies) visit IIMs and IITs regularly and even sponsor certain popular campus activities with a view to earn goodwill in the job market. ICICI Bank has gone a step ahead in striking rapport with leading academic institutions by explaining its requirements and requesting the academic leaders to create a curriculum that is relevant to market requirements. WIPRO, Infosys, Tata Motors, Intel, Convergys, etc. have an excellent relationship with leading technological institutes and universities to recruit freshers possessing employable skills and knowledge through an online testing programme. Companies like HLL, Pantaloon Retail, Reliance Industries, RPG Enterprises have joined hands with leading management institutes in creating specialised courses required by the retailing and logistics businesses. Leading audit, taxation, consultancy and BPO firms have started looking for talent in reputed undergraduate colleges all over India, especially, in cities like Delhi, Mumbai, Bangalore, Chennai and Pune. To hire the best, companies are using a variety of tools – such as group discussions, case presentations, aptitude tests, interviews, personality profiling – in recent times.

   If campus recruiting is used, steps should be taken by the Human Resource Department to ensure that recruiters are knowledgeable concerning the jobs that are to be filled in the organisation and understand and employ effective interviewing skills. Campus recruiting, however, is not easy.

6.5 RECRUITMENT SCENARIO IN INDIA

Recruitment is not simply a vacancy filling job. Recruiters are there to see that the new hires fit in with the culture of a company, possess the right mental make-up and are able to get along with colleagues smoothly. New hires must be willing to take the initiative, go that extra mile and deliver excellent results. Companies like to hire clear outperformers who are willing to handle diver and complex assignments with comfortable ease. Indian companies want new hires to understand the internal work culture and deliver results in sync with requirement. The expectations of recruiters, often, are inextricably intertwined with the corporate culture in which they operate. They are in line with the overall philosophy of the company in question. Let us summarize these in a capsule form thus:

- ***Pepsi:*** Pepsi is a flat organisation. There are a maximum of four reporting levels. Executives here emphasise achievement, motivation, the ability to deliver come what may. As the Personnel Manager of Pepsi Foods remarked "we hire people who are capable of growing the business rather than just growing with the business". Recruitees must be capable of thinking outside the box, cutting the cake of conventional barriers whenever and wherever necessary. They must have a winner's mindset and a passion for creating a dynamic change. They must have the ability to deal with ambiguity and informality.
- ***Reebok:*** As Reebok's customers are young, the company places emphasis on youth. The average age at Reebok is 26 years. Employees are expected to have a passion for the fitness business and reflect the company's aspirations. Recruitees should be willing to do all kinds of job operations. The willingness to get one's hands dirty is important. They must also have an ability to cope with informality, a flat organisation and be able to take decisions independently and perform consistently with their clearly defined goals.
- ***Indian Hotels:*** The Taj group expects the job aspirants to stay with the organisation patiently and rise with the company. Employees must be willing to say 'yes sir' to anybody. Other criteria include: communication skills, the ability to work long and stressful hours, mobility, attention to personal appearance and assertiveness without aggression.

SUMMARY

- Recruitment is the process of locating and encouraging potential applicants to apply for existing or anticipated job openings. Certain influences restrain (the freedom of) managers while choosing a recruiting source such as: image of the company, attractiveness of the job, internal policies, budgetary support, government policies etc.

- Recruitment is influenced by a variety of environmental factors – economic, social, technological, political, legal etc.
- The sources of recruitment may be broadly divided into two categories: internal sources and external sources. Both have their own merits and demerits.
- A firm may choose a particular recruiting method such as job posting, employee referral, campus hiring, advertisements, private search firms or internal promotions and transfers etc., depending on the skills required, the nature of the job and budgetary support etc.

REVIEW QUESTIONS

1. Describe briefly the various steps that are involved in hiring human resources in an organisation.
2. What are the various sources of recruitment? How can an organisation evaluate the worth of these sources?
3. List the most important merits and demerits of various sources of recruitment.
4. Discuss some ways by which firms can make campus recruiting more effective.
5. Discuss how such websites as monster.com, naukri.com or timesjobs.com have changed how companies recruit potential job applicants and how individual applicants look for jobs.

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UNIT 7 SELECTION

★ STRUCTURE ★

7.1 Introduction
7.2 Steps in the Selection Process
7.3 Reception
7.4 Screening/Courtesy Interview
7.5 Application Blank
7.6 Selection Testing
7.7 Selection Interview
❑ Summary
❑ Review Questions

7.1 INTRODUCTION

Human resource planning (HRP) identifies employment needs, job analysis determines the qualifications required and recruiting provides a pool of applicants for selection. Selection is the process of picking individuals who have relevant qualifications to fill jobs in an organisation. The basic purpose is to choose the individual who can most successfully perform the job, from the pool of qualified candidates. The selection process involves assessing the applicants to decide who will be hired. While choosing which applicants to hire, HR professionals need to take note of the following things:

1. ***Strike a fine balance between job needs and applicants' profile:*** Selection implies choosing the right candidate who is best suited for a job. To this end, the needs of the job are compared with the profiles of applicants. The most suitable person is then picked up after a rigorous process of testing and interview.
2. ***Do not pick bad apples:*** Selection should open the doors for top-notch, innovative staff who are able to deliver results. It is something that needs to be carried out carefully. Poor hiring done in a haphazard and hurried manner may prove to be a costly affair.

3. ***Legal intervention may spoil the show:*** Recruits who are turned away on account of poor performance may seek legal action against the firm. Poor selection decisions, therefore, need to be checked at the gate. HR managers must burn their candle of energies in collecting all information about job applicants, evaluate the information closely, and carry out all other relevant checks needed to reach out to the most suitable candidate.
4. ***Keep the expectations of employees in mind:*** Talent does not come cheap. If you pay peanuts, you only get monkeys and donkeys of the world. At the same time, money alone is not enough to entice talented people into a company. Innovative strategies must be put in place to get the right candidates possessing relevant qualifications, knowledge, experience and competencies.
5. ***Selection could prove to be a source of competitive advantage:*** Selecting the right candidates for a vacant position will have a number of positive consequences. Not only will they bring in talent, skills and competencies, they will help in boosting the image of the company in the market. They will attract people from their professional networks into the company. The right candidate could turn out to be a role model for others. In short, having a top-notch, flexible, innovative staff may help a firm get past competition and deliver outstanding value to customers consistently.
6. ***To be on the safe side, follow the successive hurdles technique:*** In the successive hurdles technique a number of filters are created to weed out the misfits. These hurdles or barriers are deliberately created to see that only qualified candidates go to the next stage of screening the right candidate is allowed to face the next screen.
7. ***Selection is not meant to rub people on the wrong side:*** Choosing the right candidate is not a matter of chance. It is a product of choice. To separate the mediocre from the bright, the candidates need to be put through several obstacles in a fair but rigorous manner. The standards of excellence must be defined well in advance, and only those meeting the criteria should be allowed to go to the next stage. The filtering process must be done with utmost care and caution to see that the invitees do not feel uncomfortable or develop a feeling of being taken for a ride. The series of hurdles chosen to eliminate the unwanted hands, should not rub people on the wrong side. Ultimately, there is nothing negative about the selection process, since the outcome is always positive, both for the recruiter and the recruitee.

7.2 STEPS IN THE SELECTION PROCESS

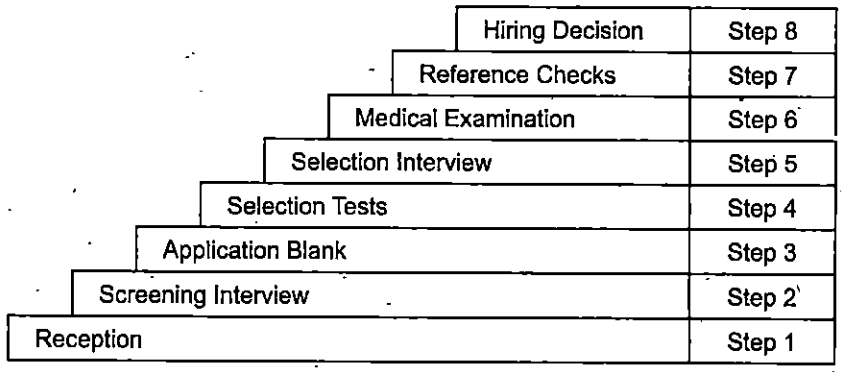

Fig. 7.1 Important steps in the selection process

7.3 RECEPTION

A company is known by the people it employs. In order to attract top talent, a company has to create a favourable impression on the applicant right from the stage of reception. Whoever meets the applicant initially should be tactful, friendly and courteous. Employment possibilities must be presented honestly and clearly. If no jobs are available at that point of time, the applicant may be asked to contact the HR department after a suitable period of time.

7.4 SCREENING/COURTESY INTERVIEW

A preliminary interview is generally planned by large organisations to cut the costs of selection by allowing only eligible candidates to go through the further stages in selection. A junior executive from the HR Department may elicit responses from applicants on important items determining the suitability of an applicant for a job such as age, education, experience, pay expectations, aptitude and location choice. This *courtesy interview*, as it is often called, helps the department screen out obvious misfits. If the department finds the candidate suitable, he or she is given a prescribed application form to fill and submit.

7.5 APPLICATION BLANK

Application blank or form is one of the most common methods used to collect information on various aspects of the applicants' academic, social, demographic, work-related background and references. It is a brief history sheet of an employee's background, usually containing personal data (address, sex, identification marks); marital data (levels of formal education, marks, distinctions); employment record (past experience, promotions, nature status (single or married, children, dependents); physical data (height, weight,

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health condition); educational of duties, reasons for leaving previous jobs, salary drawn, etc.); extra-curricular activities (sports/games, NSS, NCC, prizes won, leisure-time activities) and references (names of two or more people who certify the suitability of an applicant to the advertised position). Job seekers tend to exaggerate, or overstate their qualifications on a resume. So it's always better to ask the applicant to sign a statement that the information contained on the resume or application blank is true and that he or she accepts the employer's right to terminate the candidate's employment if any of the information is found to be false at a later date. Application blank is a highly useful selection tool, in that it serves three important purposes: (*a*) It introduces the candidate to the company in a formal way. (*b*) It helps the company to have a cross-comparison of applicants; the company can screen and reject candidates if they fail to meet the eligibility criteria at this stage itself. (*c*) It can serve as a basis for initiating a dialogue at the interview.

Weighted Application Blanks (WABs)

To make the application form more job-related, some organisations assign numeric values or weights to responses provided by applicants. Generally, the items that have a strong relationship to job performance are given high scores. For example, for a medical representative's position, items such as previous selling experience, marital status, age, commission earned on sales previously, etc.; may be given high scores when compared to other items such as religion, sex, language, place of birth, etc. The total score of each applicant is obtained by summing the weights of the individual item responses. The resulting scores are then used in the selection decision. The WAB is best suited for jobs where there are many workers, especially for sales and technical jobs and it is particularly useful in reducing turnover. There are, however, several problems associated with WABs. It takes time to develop such a form. The cost of developing a WAB could be prohibitive if the organisation has several operating levels with unique features. The WAB must be "updated every few years to ensure that the factors previously identified are still valid predictors of job success". And finally, the organisation should be careful not to depend on weights of a few items while selecting an employee.

Sample Application Blank

Name: _____

Address: _____

Phone Number (Res): _____

Education

College/University Attended: _____ Highest Degree

(a) BA/BSc/MA/MSc/MBA/MCom

(b) BE/BTech/MTech

(c) Any other

High-School Attended: _____

Work Experience (List most recent jobs first)

Name of the Organisation:

Gross Salary _____ (annual; be sure to include any bonuses or commission earned)

Job Title: _____

Name of Last Supervisor: _____

May we contact this supervisor? Yes / No

Reason(s) for Leaving: _____

_____

Name of Organisation: _____

Date of Employment: from to

Gross Salary: _____ (annual; be sure to include any bonuses or commission earned)

Job Title: _____

Name of Last Supervisor: _____

May we contact this supervisor? Yes / No

Reason(s) for Leaving: _____

_____

Work Skills

1. List any job-related languages you are able to speak or write:
2. List any job-related clerical (e.g., typing) or technical skills (e.g., computer programming) that you have:

A. _____ B. _____

C. _____

Additional Information

In case of an emergency, please contact.

Name: _____

Address: _____

Telephone: _____

_____

I understand that falsification of information is ground for dismissal.

I understand that my employment at the company may be discontinued at any time for any reason either by myself or by the company.

I agree to submit to a drug and/or alcohol test as a condition of employment.

_____ _____

Signature Date

7.6 SELECTION TESTING

A test is a sample of an aspect of an individual's behaviour. It is a systematic procedure for sampling human behaviour. Most large-scale organisations routinely use employment tests while trying to match candidates' profiles with the requirements of vacant positions. Tests measure individual differences in a scientific manner and enable the recruiter to pick up qualified applicants in an unbiased manner. Some of the commonly used employment tests are:

1. ***Intelligence tests:*** These are mental ability tests. They measure the incumbent's learning ability and also the ability to understand instructions and make judgements. The basic objective of intelligence tests is to select employees who are alert and quick at learning things so that they can be offered adequate training to improve their skills for the benefit of the organisation. Intelligence tests measure not a single trait, but rather several abilities such as memory, vocabulary, verbal fluency, numerical ability, and perception. These tests are increasingly used while hiring graduates and post-graduates for entry level management positions in banking, insurance and other financial services sectors.

2. ***Aptitude tests:*** Aptitude tests measure an individual's potential to learn certain skills – clerical, mechanical, mathematical, etc. These tests indicate whether or not an individual has the ability to learn a given job quickly and efficiently. In order to recruit efficient office staff, aptitude tests are necessary. Clerical tests, for example, may measure the candidate's ability to take notes, perceive things correctly and quickly locate things, ensure proper movement of files, etc. Aptitude tests, unfortunately, do not measure on-the-job motivation. That is why the aptitude test is administered in combination with other tests like intelligence and personality tests.
3. ***Personality tests:*** Personality is a unique mix of individual characteristics that can affect how people actually contribute in a workplace. Many organisations use personality tests that measure the degree to which the candidates' attributes (such as careful, hard working, tolerant, trusting, outgoing, venturesome, emotionally stable, open to ideas, creative) match specific job criteria. There are three types of personality tests: projective test, interest test, and preferences test.
4. ***Achievement tests:*** These are designed to measure what the applicant can do on the job currently, i.e., whether the testee actually knows what he or she claims to know. A typing test shows typing proficiency, while a shorthand test measures the testee's ability to take dictation and transcribe. Such proficiency tests are also known as work sampling tests. Work sampling is a selection test wherein the job applicant's ability to do a small portion of the job is tested. These tests are of two types; Motor, involving physical manipulation of things (e.g., trade tests for carpenters, plumbers, electricians) or Verbal, involving problem situations that are primarily language-oriented or people-oriented (e.g., situational tests for supervisory jobs). Since work samples are miniature replicas of actual job requirements, they are difficult to fake. They offer concrete evidence of the proficiency of an applicant as against his ability to do the job. However, work-sample tests are not cost effective, as each candidate has to be tested individually. It is not easy to develop work samples for each job. Moreover, it is not applicable to all levels of the organisation. For managerial jobs it is often not possible to develop a work sample test that can take one of all the full range of managerial abilities.
5. ***Simulation tests:*** Simulation exercise is a test which duplicates many of the activities and problems an employee faces while at work. Such exercises are commonly used for hiring managers at various levels in an organisation. To assess the potential of a candidate for managerial positions, assessment centres are commonly used.
6. ***Graphology tests:*** Graphology involves a trained evaluator to examine the lines, loops, hooks, strokes, curves and flourishes in a person's handwriting to assess the person's personality and emotional make-up. The recruiting company may, for example, ask applicants to

complete application forms and write about why they want a job. These samples may be finally sent to a graphologist for analysis and the results may be put to use while selecting a person. The use of graphology, however, is dependent on the training and expertise of the person doing the analysis. In actual practice, questions of validity and just plain skepticism have limited its use.

7. ***Polygraph (lie-detector) tests:*** The polygraph records physical changes in the body as the test subject answers a series of questions. It records fluctuations in respiration, blood pressure and perspiration on a moving roll of graph paper. The polygraph operator forms a judgement as to whether the subject's response was truthful or deceptive by examining the biological movements recorded on the paper. Polygraphs, despite strong resistance by many applicants, are increasingly being used by companies which have problems with inventory and security of funds. Government agencies have begun to use the polygraph, especially for filling security, police, fire and health positions. Critics, however, question the appropriateness of polygraphs in establishing the truth about an applicant's behaviour.
8. ***Integrity tests:*** These are designed to measure the employee's honesty to predict those who are more likely to steal from an employer or otherwise act in a manner unacceptable to the organisation. The applicants who take these tests are expected to answer several 'yes' or 'no' type questions, such as: Have you ever told a lie? Do you report to your boss if you know of another employee stealing from the store? Do you carry office stationery back home for personal use? Do you mark attendance for your colleagues also?

CASE STUDY HR Practices: How do they do Employee Testing in India?

Institutions like NIIT and Aptech design tests for various companies across verticals and IT companies in particular. NIIT, for instance, does recruitment tests, internal competency tests, regulatory compliance tests, vendor-specific certification tests, etc. for specific industry verticals. The test division of Aptech, Attest, offers contemporary technology-based testing and assessment solution. The content of the tests is generally based on specific job requirements. For instance, for software companies this would translate to specific technical skills. For BPO companies it would mean the required level of competence in language, communication skills (written and oral), computer literacy, listening comprehension, mental and quantitative ability, etc. NIIT follows a multi-level process validation model. After the questions are formulated on the basis of analysis of the client's requirement and the expert advice, the test is then subjected to validity by getting it answered by the best of breed industry professionals who are already working on the positions for which the test is meant. The answers are then verified and checked by the domain expert team. The tests are also assessed through various assessment engines, which help to customise the test.

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7.8 SELECTION INTERVIEW

Interview is the oral examination of candidates for employment. This is the most essential step in the selection process. In this step, the interviewer tries to obtain and synthesise information about the abilities of the interviewee and the requirements of the job. Interview gives the recruiter an opportunity to (a) size up the interviewee's agreeableness; (b) ask questions that are not covered in tests; (c) obtain as much pertinent information as possible; (d) assess subjective aspects of the candidate – facial expressions, appearance, nervousness and so forth; (e) make judgements on interviewee's enthusiasm and intelligence; and (f) give facts to the candidate regarding the company, its policies, programmes, etc., and promote goodwill towards the company. Several types of interviews are commonly used depending on the nature and importance of the position to be filled within an organisation.

- ***The non-directive interview:*** In a non-directive interview, the recruiter asks questions as they come to mind. There is no specific format to be followed. The questions can take any direction. The interviewer asks broad, open-ended questions such as 'tell me more about what you did on your last job' and allows the applicant to talk freely with a minimum of interruption. Difficulties with a non-directive interview include keeping it job related and obtaining comparable data on various applicants.
- ***The directive or structured interview:*** In the directive interview, the recruiter uses a predetermined set of questions that are clearly job related. Since every applicant is asked the same basic questions, comparison among applicants is easier. Structured questions improve the reliability of the interview process, eliminate biases and errors and may even enhance the ability of a company to withstand legal challenges. On the negative side, the whole process is somewhat mechanical, restricts the freedom of interviewers and may even convey disinterest to applicants who are used to more flexible interviews. Also, designing a structured interview may take a good amount of time and energy.
- ***The situational interview:*** One variation of the structured interview is known as the situational interview. In this approach, the applicant is confronted with a hypothetical incident and asked how he or she would respond to it. The applicant's response is then evaluated relative to pre-established benchmark standards.
- ***The behavioural interview:*** The behavioural interview focuses on actual work incidents (as against hypothetical situations in the situational interview) in the applicant's past. The applicant is supposed to reveal what he or she did in a given situation, for example, how he disciplined an employee who was smoking inside the factory premises.

- ***Stress interview:*** In stress interview, the interviewer attempts to find how applicants would respond to aggressive, embarrassing, rude and insulting questions. The whole exercise is meant to see whether the applicant can cope with highly stress-producing, anxious and demanding situations while at work, in a calm and composed manner. Such an approach may backfire also, because the typical applicant is already somewhat anxious in any interview. So, the applicant is very keen that the firm should hire might even turn down the job offer under such trying conditions.
- ***Group discussion interview:*** In this type of an interview, groups rather than individuals are interviewed. The interviewees are given certain problems and are asked to reach a specific decision within a particular time limit. The applicants enter into group discussions, knowing that the interview is a test, but do not know which qualities are being measured or tested. A few observers watch the activities of the interviewees – those who take a lead in the discussion, those who try influencing others, those who summarise and clarify issues and those who speak effectively. The assumption underlying this type of interview is that 'the behaviour displayed in the solution of the problem is related to potential success in the job. The object is to see how well individuals perform on a particular task or in a particular situation.'
- ***Panel or Board interview:*** In a typical panel interview, the applicant meets with three to five interviewers who take turns asking questions. After the interview, the interviewers pool their observations to arrive at a consensus about the suitability of the applicant. The panel members can ask new and incisive questions based on their expertise and experience and elicit deep and meaningful responses from candidates. Such an interview could also limit the impact of personal biases of any individual interviewer. On the negative side, as an applicant, a panel interview may make the candidate feel more stressed than usual.

7.8.1 The Interview Process

Interviewing is an art. It demands a positive frame of mind on part of the interviewers. Interviewees must be treated properly so as to leave a good impression (about the company) in their minds. HR experts have identified certain steps to be followed while conducting interviews.

Preparation: Effective interviews need to be planned, which involves:

- Establishing the objectives of the interview and determining the areas and specific questions to be covered.
- Reviewing the candidate's application and resume, noting areas that are vague or that may show candidate's strengths and weaknesses on which questions could be asked.

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- Keeping the test scores ready, along with interview assessment forms.
- Selecting the interview method to be followed.
- Choosing the panel of experts who would interview the candidates (list the number of experts to be called plus the chairman).
- Identifying a comfortable, private room preferably away from noise and interruptions (neat and clean; well furnished, lighted and ventilated) where the interview could be held.

Reception: The candidate should be properly received and led into the interview room. He should be greeted with a warm, friendly smile. As a rule, treat all candidates – even unsolicited drop-ins at your office – courteously, not on humanitarian grounds but because your company's reputation is at stake. Start the interview on time.

Information exchange: To gain the confidence of the candidate, start the interview with a cheerful conversation. The information exchange between the interviewer and the interviewee may proceed thus:

- State the purpose of the interview, how the qualifications are going to be matched with skills needed to handle the job. Give information about the job for which the interviewee is applying. Known as a realistic job preview, such an exercise would be most fruitful when the applicant gets a realistic picture of what he is supposed to do on the job.
- Begin with open-ended questions where the candidate gets enough freedom to express himself freely instead of 'yes' or 'no' type of responses.
- Do not put words in the applicant's mouth by asking: You have worked in a private management institute before. Haven't you?
- Do not telegraph the desired answer by nodding or smiling when the right answer is given.
- Do not interrogate the applicant as if the person is a prisoner and do not be patronising, sarcastic or ultra-critical.
- Do not monopolise the conversation, giving very little chance to the applicant to reveal himself.
- Do not let the applicant dominate the interview by rambling from point to point so you cannot ask all your questions. Establish an interview plan and stick to it.
- Do not use difficult words to confuse the applicant. Provide information as freely and honestly as possible
- Focus on the applicant's education, training, work experience, etc. Find unexplained gaps in the applicant's past work or college record and elicit facts that are not mentioned in the resume. Avoid questions that are not job-related.
- Listen to the applicant's answers attentively and patiently. And pay attention to non verbal cues (applicant's facial expressions, gestures,

body language, etc.). To increase reliability and avoid discrimination, ask the same questions of all applicants for a particular job. Keep careful notes and record facts.

Termination: End the interview as happily as it began without creating any awkward situation for the interviewee. Here, avoid communicating through unpleasant gestures such as sitting erect, turning towards the door, glancing at watch or clock, etc. Regardless of the interview performance of the candidate and interviewer's personal opinion, the applicant should not be given any indication of his prospects at this stage.

Evaluation: After the interview is over, summarize and record your observations carefully, constructing the report based on responses given by applicant, his behaviour, your own observations and the opinions of other experts present during the interview. It is always better to use a standardised evaluation form for this purpose.

7.8.2 Guidelines for an Effective Interview

Both the interviewer and the interviewee should have respect for established norms and practices for a successful interview. The following guidelines aim at running the show in a competent manner: The following guidelines will help the interviewer to conduct the process in a competent manner.

- ***Understand the requirements of the job:*** Interviewers should possess a thorough knowledge of the job and its multifarious requirements.
- ***Possess requisite skills, training and experience:*** Interviewers should know how to conduct the interview in a dignified manner. Skillful interviewing is an art and like all other arts, requires training and experience.
- ***Look into relevant data carefully:*** The interviewers should focus attention on whether the candidate in question fits in with job requirements or not. To this end, they must put questions that reveal more about the candidate's traits, aptitude, interest, etc.
- ***Examine Important factual information before forming an opinion:*** Before forming an opinion, interviewers should focus attention on (*a*) reliance of education to the job specifications; (*b*) reasons for the gap in educational and employment history of the applicant; (*c*) reasons for choosing special courses in schools and colleges; (*d*) division or grades obtained and academic achievements; reason for failure; (*e*) likes and dislikes for each job; (*f*) information regarding domestic, health, financial and other problems, if any; (*g*) the condition of the job and work the applicant expects.
- ***Avoid wasting time in background checks:*** The time of the interview should not be consumed in collecting routine information, which can be easily gathered from application blank or verified from the applicant's former employer or from his school, institution, records and documents, certificates, etc.

- ***Look at the forest, not the individual trees:*** The interview should be diligently delimited, for it is often the only feasible way of eliciting the required information about the candidate. It enables the interviewers to view the total individual and to appraise his personal appearance, comments, attitudes, mannerisms, motivations, interests, adjustments, temperament and other personal attributes.
- ***Take an objective view and avoid prejudices of all kinds:*** The interviewer's decision should be fair and impartial. Bias, prejudices, personal likes and dislikes, preferences and general impression of the candidate should not interfere with the decision.
- ***Allow the candidate(s) to speak freely and be a good listener:*** The candidate should be given an opportunity to air his feelings, opinions and thoughts freely. To this end, a time limit can be set well in advance. To elicit the requisite information the interviewer should take the backseat and ask relevant questions.
- ***Do not rush to a conclusion very quickly:*** The interviewer should refrain from passing too quick a judgement before all the relevant facts have been gathered and evaluated.
- ***Give courteous and respectful treatment to job applicants:*** Due respect is to be paid to all job applicants, this is a must. To put the candidate at ease, the interviewer should treat all job applicants in a fair and equitable maner.
- ***Leave a good impression on job applicants:*** The interviewer, finally, should try to give good impression about himself and of the company he represents.

The following guidelines will help the interviewees to handle the process in a competent manner:

- ***Preparation of a resume:*** The interviewee must be armed with a well designed resume containing all relevant information – such as
- (i) Demographic data (name, permanent address, date of birth, marital status, and telephone number, if any); (ii) career objectives, both for short range (such as staff assistant or labour relations) and long range (e.g., contract negotiator); (iii) educational background and academic achievements; (iv) leadership positions in clubs, athletic teams, students' union and social organisation, and (v) previous work experience.
- ***Preparation for the interview itself:*** The applicant should prepare himself fully before attending the interviews. He should do some background study of the company (such as its history and recent annual report) in order to ask specific questions about product, process, goals or competition. Questions on items that are related to job duties, the reason for joining the organisation, should be thoroughly prepared. These questions demonstrate interest in the organisation.

- ***Make a good impression during the interview:*** To make a good impression and highlight their positive aspects, the interviewee must follow these considerations: (i) appropriate clothing; (ii) good grooming; (iii) a firm handshake; (iv) the appearance of controlled energy; (v) pertinent humour and readiness to smile: (vi) a genuine interest in the employers' operations and alert attention when the interviewer speaks; (vii) pride in past performance; (viii) an understanding of the employer's needs and a desire to serve them; (ix) the display of sound ideas; and (x) ability to take control when employers falter or hesitate during the interview.
- ***Keep responses measured:*** The interviewee should not initiate any discussion on his own. The response should always be in a measured tone, precise and to the point. There is no need to be pompous or turn egoistical. Of course, eye contact is important.
- ***Follow up:*** A clear statement of the next action should be obtained before concluding the interview and a follow up letter from the interviewee acknowledging the interview should be sent within a few days.

6. ***Medical examination:*** Certain jobs require physical qualities like clear vision, acute hearing, unusually high stamina, tolerance of arduous working conditions, clear tone of voice, etc. Medical examination reveals whether or not a candidate possesses these qualities. Medical examination can give the following information:
   - Whether the applicant is medically suitable for the specific job or not
   - Whether the applicant has health problems or psychological attitudes likely to interfere with work efficiency or future attendance
   - Whether the applicant suffers from bad health which should be corrected before he can work satisfactorily (such as the need for spectacles)
   - Whether the applicant's physical measurements are in accordance with job requirements or not.
7. ***Reference checks:*** Once the interview and medical examination of the candidate is over, the personnel department will engage in checking references. Candidates are required to give the names of two or three references in their application forms. These references may be from individuals who are familiar with the candidate's academic achievements, or from the applicant's previous employer, who is well-versed with the applicant's job performance, and sometimes from co-workers. Reference checks are taken as a matter of routine and treated casually or omitted entirely in many organisations. But a good reference check, when used sincerely, will fetch useful and reliable information to the organisation.

8. ***Hiring decision:*** The concerned line manager has to make the final decision now – whether to select or reject a candidate after soliciting the required information through different techniques discussed earlier. The line manager has to take adequate care in taking the final decision because of economic, behavioural and social implications of the selection decisions. A careless decision of rejecting a candidate would impair the morale of the people and cause them to suspect the selection procedure and the very basis of selection in a particular organisation. A true understanding between line managers and HR managers should be established so as to facilitate good selection decisions. After taking the final decision, the organisation has to intimate this decision to the successful as well as unsuccessful candidates. The organisation sends the appointment order to the successful candidates either immediately or after some time, depending upon its time schedule.

SUMMARY

- Selection is the process of choosing individuals who have relevant qualifications to fill jobs in an organisation. The primary purpose of selection activities is to predict which job applicant will be successful if hired
- Selection is usually a series of hurdles or steps. Each one must be successfully cleared before the applicant proceeds to the next
- The selection process – from reception through initial screening, application, testing, interview, medical and reference checking – must be handled by trained, knowledgeable individuals
- Selection tests include intelligence and aptitude tests, achievement tests, assessment centres and general psychological or personality tests. The value of tests should not be discounted, since they are objective and offer a broader sampling of behaviour
- The interview is an important source of information about job applicants. Several types of interviews are used, depending on the nature and importance of the position to be filled within an organisation. Interviews can be conducted by a single individual or by a panel of interviewers who are generally trained for the purpose. The training helps interviewers to be more objective and not get carried away by biases and errors of various kinds.

REVIEW QUESTIONS

1. Describe briefly the various steps that are involved in hiring human resources in an organisation.
2. What are the various sources of recruitment? How can an organisation evaluate the worth of these sources?

3. Outline the legal, economic, social and political considerations in recruitment.
4. Explain in brief the various selection techniques in general. Outline those selection techniques which are popularly used in India.
5. Outline the factors that affect selection decisions in multiple unit organisations.
6. What is an application blank? What is its role and importance in selecting management trainees in a large public sector undertaking?
7. What is testing in selection? Explain its validity and reliability in the selection process. What types of tests do you adopt for selecting mechanical engineers in a large tool making industry?
8. What is an interview? Explain its validity and reliability. What are the different types of employment interviews?
9. Write notes on:
   (*a*) Personality Tests
   (*b*) Achievement Tests
   (*c*) Polygraph
   (*d*) Graphology

UNIT 8 TRAINING AND EXECUTIVE DEVELOPMENT

NOTES

★ STRUCTURE ★

8.1 Introduction
8.2 Training, Development and Education
8.3 Purposes of Training
8.4 Importance
8.5 Types of Training
8.6 Designing a Training Programme: A Systematic Approach
8.7 Role Specific and Competency Based Training
8.8 Training Process Outsourcing
8.9 Principles of Training
8.10 Executive Development
- Summary
- Review Questions

8.1 INTRODUCTION

Training involves changing skills, knowledge, attitudes or behaviour. It aims at bringing a relatively permanent change in employees so that they are able to perform their jobs well. Jobs in most modern organisations have become complex and challenging. To deliver results, employees need to constantly update their knowledge and skills in performing jobs efficiently and effectively.

8.2 TRAINING, DEVELOPMENT AND EDUCATION

Training is a planned effort aimed at improving the job-related competencies of an employee. These include knowledge, skills or behaviours that are critical for successful job performance. Training involves giving new or current employees the specific skills and knowledge they need to perform their jobs well.

Development, in contrast, is considered to be more general than training and more oriented to individual needs in addition to organisational needs and it is most often aimed toward management of people. There is more theory involved with such education and hence less concern with specific

behaviour than is the case with training. Usually, the intent of development is to provide knowledge and understanding that will enable people to carry out non-technical organisational functions more effectively.

The term 'education' is wider in scope and more general in purpose when compared to training. Training is the act of increasing the knowledge and skills of an employee while doing a job. It is job-oriented (skill learning). Education, on the other hand, is the process of increasing the general knowledge and understanding of employees. It is a person-oriented, theory-based knowledge with the main purpose of improving the understanding of a particular subject or theme (conceptual learning). Its primary focus is not the job of an operative. Education is imparted through schools or colleges and the contents of such a programme generally aim at improving the talents of a person. Training is practice-based and company-specific. However, both have to be viewed as programmes that are complementary and mutually supportive. Both aim at harnessing the true potential of a person/employee.

8.3 PURPOSES OF TRAINING

Training is needed to serve the following purposes:

- Newly recruited employees require training so as to perform their tasks effectively. Instruction, guidance, coaching help them to handle jobs competently, without any wastage.
- Training is necessary to prepare existing employees for higher-level jobs (promotion).
- Existing employees require refresher training so as to keep abreast of the latest developments in job operations. In the face of rapid technological changes, this is an absolute necessity.
- Training is necessary when a person moves from one job to another (transfer). After training, the employee can change jobs quickly, improve his performance levels and achieve career goals comfortably.
- Training is necessary to make employees mobile and versatile. They can be placed on various jobs depending on organisational needs.
- Training is needed to bridge the gap between what the employee has and what the job demands. It helps make employees more productive and useful in the long-run.
- Training is needed for employees to gain acceptance from peers (learning a job quickly and being able to pull their own weight is one of the best ways for them to gain acceptance).

8.4 IMPORTANCE

Training is a vital investment because the payoffs are immeasurable in terms of employee growth, involvement and commitment. It is an important tool of HRM as it helps to

control the attrition rate – it helps in motivating people to stay on, acquire new skills and remain continually useful to the organisation; it helps in increasing the job knowledge and skills of employees at each level. The importance of training can be studied under the following heads:

Importance of Training

Benefits to the business	Benefits to the employees
• Trained workers are more efficient.	• Training makes an employee more skilled.
• In case of industry, training improves safety, as it imparts knowledge on the proper use of machines and equipment with due regard to safety and possible hazards.	• Internal growth opportunities improve, as the employee acquires new skills. Training also helps an employee to move to another organisation and pursue career goals actively.
• Trained workers show superior performance.	• Trained employees can avoid mistakes or accidents on the job. They are confident, more satisfied and high on morale.
• Training makes employees more loyal and they will be less inclined to leave the unit where there are growth opportunities.	• Training enables employees to cope with organisational, social and technological changes. Effective training is an invaluable investment in the human resources of an organisation.

8.5 TYPES OF TRAINING

There are many approaches to training. The following types of training are commonly employed in present-day organisations.

- ***Skills training:*** This type of training is most common in organisations. The process here is fairly simple. The need for training in basic skills (such as reading, writing, computing, speaking, listening, problem solving, managing oneself, knowing how to learn, working as part of a team, leading others) is identified through assessment. Specific training objectives are set and training content is developed to meet those objectives.
- ***Refresher training:*** Rapid changes in technology may force companies to go in for this kind of training. By organising short-term courses which incorporate the latest developments in a particular field, the company may keep its employees up-to-date and ready to take on emerging challenges. It is conducted at regular intervals by taking the help of external consultants who specialise in a particular descriptive.

- ***Cross-functional training:*** This involves training employees to perform operations in areas other than their assigned job. There are many approaches to cross-functional training. Job rotation can be used to provide a manager in one functional area with a broader perspective than he would otherwise have. Departments can exchange personnel for a certain period so that each employee understands how other departments are functioning. High performing workers can act as peer trainers and help employees develop skills in another area of operation.
- ***Team training:*** Companies are investing heavy amounts, nowadays, in training new employees to listen to each other and to cooperate. They are using outdoor experiential training techniques to develop teamwork and team spirit among their employees (such as scaling a mountain, preparing recipes for colleagues at a restaurant, sailing through uncharted waters, crossing a jungle etc.). The training basically throws light on (i) how members should communicate with each other (ii) how they have to cooperate and get ahead (iii) how they should deal with conflict situations (iv) how they should find their way, using collective wisdom and experience to good advantage.
- ***Creativity training:*** Companies like Mudra Communications, Titan Industries, Wipro encourage their employees to think unconventionally, break the rules, take risks, go out of the box and devise unexpected solutions.In creativity training, trainers often focus on three things: (i) breaking away from traditional, conventional ways of doing things; (ii) generating new ideas through consultation, interaction, switching over to new perspectives, cross-fertilisation of ideas and using the right part of the brain and (iii) brainstorming. Brainstorming (getting a large number of ideas from a group of people in a short time) often helps in generating as many ideas as possible without pausing to evaluate them. It helps in releasing ideas, overcoming inhibitions, cross fertilising ideas and getting away from patterned thinking.
- ***Diversity training:*** Diversity training aims to create better cross-cultural sensitivity with the aim of fostering more harmonious and fruitful working relationships among a firm's employees (irrespective of differences in age, race, gender, disabilities, lifestyles, culture, education and backgrounds).
- ***Literacy training:*** Tutorial programmes, home assignments, reading and writing exercises, simple mathematical tests, etc., are generally used in all company in-house programmes meant to improve the literacy levels – such as the ability to read, write and speak well – of employees with weak reading, writing or arithmetic skills.
- ***Orientation training:*** In orientation training, new hires get a first-hand view of what the company stands for, how the work is carried out and how to get along with colleagues.

8.6 DESIGNING A TRAINING PROGRAMME: A SYSTEMATIC APPROACH

The key steps involved in designing a training programme may be listed thus:

Steps involved in Designing an Appropriate Training Programme

Assessment of training needs	Identification of training objectives	Organising the training programme	Evaluation of the training programme
• Organisation analysis • Task analysis • Person analysis	• Innovative • Problem solving • Regular	• Responsibility for training • Shortlisting trainers & trainees • Training content and period • Implementation	• Questionnaires • Tests • Interviews • Studies • Cost-benefit analysis • Feedback

8.6.1 Identification of Training and Development Needs

Training efforts must aim at meeting the requirements of the organisation (long-term) and the individual employees (short-term). This involves finding answers to questions such as whether training is needed. If yes, where is it needed? Which training is needed? Once we identify training gaps within the organisation, it becomes easy to design an appropriate training programme. Training needs can be identified through the following types of analysis:

8.6.2 Organisational Analysis

It involves a study of the entire organisation in terms of its objectives, its resources, the utilization of these resources, in order to achieve stated objectives and its interaction pattern with environment. The important elements that are closely examined in this connection are:

- ***Analysis of objectives:*** This is a study of short-term and long-term objectives and the strategies followed at various levels to meet these objectives.
- ***Resource utilization analysis:*** How can the various organisational resources (human, physical and financial) be put to use is the main focus of this study. The contributions of various departments are also examined by establishing efficiency indices for each unit. This is done to find out comparative labour costs, whether a unit is under-manned or over-manned.
- ***Environmental scanning:*** Here the economic, political, socio-cultural and technological environment of the organisation is examined.

- ***Organisational climate analysis:*** The climate of an organisation speaks about the attitudes of members towards work, company policies, supervisors, etc. Absenteeism and turnover ratios generally reflect the prevailing employee attitudes. These can be used to find out whether training efforts have improved the overall climate within the company or not.

8.6.3 Task or Role Analysis

This is a detailed examination of a job, its components, its various operations and conditions under which it has to be performed. The focus here is on the roles played by an individual and the training needed to perform such roles. The whole exercise is meant to find out how the various tasks have to be performed and what kind of skills, knowledge, attitudes are needed to meet the job needs. Questionnaires, interviews, reports, tests, observation and other methods are generally used to collect job-related information from time to time.

8.6.4 Person Analysis

Here the focus is on the individual in a given job. There are three issues to be resolved through manpower analysis. First, we try to find out whether performance is satisfactory and training is required. Second, whether the employee is capable of being trained and the specific areas in which training is needed. Finally, we need to state whether poor performers (who can improve with requisite training inputs) on the job need to be replaced by those who can do the job. Other options to training such as modifications in the job or processes should also be looked into. Personal observation, performance reviews, supervisory reports, diagnostic tests help in collecting the required information and select particular training options that try to improve the performance of individual workers.

To be effective, training efforts must continuously monitor and coordinate the three kinds of analyses described above. An appropriate programme that meets the company's objectives, task and employee needs may then be introduced. Further, the training needs have to be prioritised so that the limited resources that are allocated to fill training gaps are put to use in a proper way.

8.6.5 Identify Training Objectives

Once training needs are identified, objectives should be set to begin meeting these needs.

Objectives of Training

Innovative	Problem solving	Regular
• Anticipating problems before they occur. • Team-building sessions with the departments.	• Training clerks to reduce complaints. • Training supervisors in communication to reduce grievances.	• Orientation Recurring training of Trainers. • Refresher courses in safety procedures.

Training objectives can be of three types. The most basic training takes place through orientation programmes. The second type of training objective is problem solving. The focus is on solving a specific problem instead of providing general information about a problem area. The final objective is innovation. Here the emphasis is on changing the mind set of workers, supervisors and executives working at various levels.

8.6.6 Organisation of a Training Programme

Training is serious business. So certain basic things need to be established beforehand in order to run the show smoothly:

- ***Responsibility for training:*** Top management should lay down the training policy and earmark a specific sum as training budget. The HR department should establish a clear-cut criteria before presenting opportunities to operatives.
- ***Shortlisting trainees:*** The question of who is to be trained – new or old workers, skilled and unskilled – should be given considerable time and attention to avoid problems such as bias, favouritism and nepotism. Training opportunities must be thrown open to all without any discrimination.
- ***Identifying the trainers:*** Skilled, knowledgeable and experienced trainers must be identified well in advance. Only competent people should be allowed to handle this job. If required, the trainer identified for this purpose should receive instruction, guidance and help from senior executives who are well-versed with the nuances of the game.
- ***Determining training content and period:*** Training materials, including notes, case studies, brochures, manuals, educational films, should also be identified beforehand. Training content should be printed and circulated to all trainees so that they attend classes after some amount of preparation. The duration of the training needs to be planned according to the nature of the training.
- ***Implementation of the programme:*** The actual implementation of the training needs to be done keeping the skill and learning capabilities of the trainees. The trainer must put the trainees at ease. Audio visual aids, interesting case studies and real life examples should be used extensively to sustain the interest of audience. Interactive elements encourage the trainees to get involved and make the programme participative.

8.6.7 Evaluation of a Training Programme

Training evaluation checks whether training has had the desired impact or not. It also tries to ensure whether candidates are able to implement their learning in their respective workplaces or not. Important methods used to evaluate training effort may be listed thus:

- ***Questionnaires:*** Comprehensive questionnaires could be used to obtain opinions, reactions, and views of trainees.
- ***Tests:*** Standard tests could be used to find out whether trainees have learnt anything during and after the training.
- ***Interviews:*** Interviews could be conducted to find the usefulness of training offered to operatives.
- ***Studies:*** Comprehensive studies could be carried out eliciting the opinions and judgements of trainers, superiors and peer groups about the training.
- ***Human resource factors:*** Training can also be evaluated on the basis of employee satisfaction, which in turn can be examined on the basis of decrease in employee turnover, absenteeism, accidents, grievances, discharges, dismissals, etc.
- ***Cost-benefit analysis:*** The costs of training (cost of hiring trainers, tools to learn, training centre, wastage, production stoppage, opportunity cost of trainers and trainees) could be compared with its value (in terms of reduced learning time, improved learning, superior performance) in order to evaluate a training programme.
- ***Feedback:*** After the evaluation, the situation should be examined to identify the probable causes for gaps in performance. The training evaluation information (about costs, time spent, outcomes, etc.) should be provided to the instructors, trainees and other parties concerned for control, correction and improvement of trainees' activities. The training evaluator should follow it up sincerely so as to ensure effective implementation of the feedback report at every stage.

8.7 ROLE SPECIFIC AND COMPETENCY BASED TRAINING

A competency is a set of knowledge, skills, behaviours, attitudes and characteristics that distinguish one person from another. To achieve career growth and development, employees should be focusing attention on three types of competencies namely – functional, personal and business-related. Functional competencies relate to technical knowledge and skills needed to gain mastery over one's field – such as accounting and taxation principles. Personal competencies relate to individual skills and attitudes required to deal with professional relationships successfully, for example having excellent interpersonal skills. Business competencies relate to the ability to look at issues and situations from the business point of view. Once an organisation is able to identify these competencies for various positions, these can be used to selection and development of employees. Competency based training puts emphasis on what a person can do in the workplace as a result of completing a programme of training or based on

workplace experience and learning. Ideally, progress within a competency based training programme is not based on time. As soon as trainees have achieved or demonstrated the required competency, they can move to the next competency. In this way, trainees may be able to complete a program of study much faster. Competency Based Training is based on the concept that people can learn transferable skills and most training is transferable.

8.8 TRAINING PROCESS OUTSOURCING

Outsourcing is simply obtaining work previously done by employees inside the company from sources outside the company. If someone has specialised in an activity – which is not strategically critical to our business – and is able to do that cost-effectively, it is better to get it from outside. You get benefited in the form of excellent quality, reliable supply and rock bottom price. You can also focus exclusively on doing what you are good at (the so called mission critical activities) – thereby enhancing your own competitive advantage. For example, Dell outsources the manufacture of its computers. It concentrates all its efforts on enhancing its Web-based direct sales capability and does not dilute its energies on other aspects of the game.

Outsourcing, not surprisingly, is a big hit with many global firms. Companies such as Nike and Reebok have succeeded by focusing on their core strengths in design and marketing and contracting all their footwear manufacturing to outside suppliers. Outsourcing is changing the way HR departments operate as well. Technology makes it easy to outsource HR activities to specialist service providers, by allowing service providers real time internet based access to the employer's human resource information database. Payroll, benefits, applicant testing and screening, carrying out reference checks, exit interviews, employee training etc are some of the popular human resource tasks that are being outsourced currently. Companies are outsourcing more HR activities now-a-days because the transactional functions could be turned over to a service provider – with a process and technology expertise – and the core company can concentrate its efforts on strategic acquisition, motivation and retention of talent which by all means is critical to business success.

8.8.1 What is Training Process Outsourcing?

Good employees need to feel valued. They want to know that development programs are available, so that they can have the skills needed to do their jobs and grow in their careers. They also want to know that their employers will help them remain marketable in case they have to find new employment. When an organisation gets its employees trained by an outside agency, it is called training process outsourcing. The training process has many of the same characteristics of other business functions

that have been successfully outsourced. Training programs will benefit from best practices and procedures, new systems and new technology, and also from the leverage that outsourcing brings inside an enterprise and from enterprise to enterprise. Outsourcing enables a client to reduce unit cost and head count, reduce its training investment, leverage existing assets, and ensure that the best talent is being used to deliver training. Training process outsourcing can bring in the following benefits:

- Many experts feel that outsourced training offering is a simpler, cheaper, faster, better value proposition.
- TPO helps a firm focus its energies on its core strengths – activities that it can perform better than its rivals
- Heavy investments in building expensive training infrastructure can be avoided
- Specialist training agencies are able to deliver excellent results – since they carry it out again and again meeting clients from various sectors. The resultant cross fertilisation of ideas can immensely help firms not having enough domain expertise and exposure. When professionals run the show, they are able to bring in impressive cost savings as well – in terms of head count and by freeing internal experts to work on other important areas of a company.

Outsourcing is simply obtaining work done, previously by employees inside the company, from sources outside the company. For an organisation it is better to outsource activities, which are not strategically critical to its business, and get it done from outside by someone who has specialised in and is able to do that cost-effectively. This way the organisation gets benefited in the form of excellent quality, reliable supply and rock-bottom price. Moreover, it can also focus exclusively on doing what it is good at (the so-called mission critical activities) thereby enhancing its competitive advantage.

8.9 PRINCIPLES OF TRAINING

Training is essential for job success. It can lead to higher production, fewer mistakes, greater job satisfaction and lower turnover. These benefits accrue to both the trainee and the organisation, if managers understand the principles behind the training process. To this end, training efforts must invariably follow certain learning-oriented guidelines.

- ***Modelling:*** Modelling is simply copying someone else's behaviour. Passive classroom learning does not leave any room for modelling. If we want to change people, it would be a good idea to have videotapes of people showing the desired behaviour. The selected model should provide the right kind of behaviour to be copied by

others. A great deal of human behaviour is learned by modelling others. Children learn by modelling parents and older children, they are quite comfortable with the process by the time they grow up. As experts put it, 'managers tend to manage as they were managed'.

- ***Motivation:*** Motivation to learn is influenced by the answers to questions such as 'How important is my job to me? How important is the information? Will learning help me progress in the company?' People learn more quickly when the training and the subject is important and relevant to them. Learning is also faster and long-lasting when the learner participates actively. Most people, for example, never forget how to ride a bicycle because they took an active part in the learning process!
- ***Reinforcement:*** If a behaviour is rewarded, it probably will be repeated. Positive reinforcement consists of rewarding desired behaviours. People avoid certain behaviours that invite criticism and punishment. A bank officer would want to do a post graduate course in finance, if it earns him increments and makes him eligible for further promotions. Both the external rewards (investments, praise) and the internal rewards (a feeling of pride and achievement) associated with desired behaviours encourage subjects to learn properly. To be effective, the trainer must reward desired behaviours only. If he rewards poor performance, the results may be disastrous: good performers may quit in frustration, accidents may go up and productivity may suffer.
- ***Feedback:*** People learn best if reinforcement is given soon after training. Positive feedback (showing the trainee the right way of doing things) is to be preferred to negative feedback (telling the trainee that he is not correct) when we want to change behaviour.
- ***Spaced practice:*** Learning takes place easily if the practice sessions are spread over a period of time. New employees learn better if the orientation programme is spread over a two- or three-day period, instead of covering it all in one day. For memorising tasks, 'massed' practice is usually more effective. Imagine the way schoolchildren say the Lord's prayer aloud. Can you memorise a long poem by learning only one line per day? You tend to forget the beginning of the poem by the time you reach the last stanza. For 'acquiring' skills as stated by Mathis and Jackson, spaced practice is usually the best. This incremental approach to skill acquisition minimizes the physical fatigue that deters learning.
- ***Whole learning:*** The concept of whole learning suggests that employees learn better if the job information is explained as an entire logical process, so that they can see how the various actions fit together into the 'big picture'. A broad overview of what the trainee would be doing on the job should be given top priority, if learning has

to take place quickly. Research studies have also indicated that it is more efficient to practice a whole task all at once rather than trying to master the various components of the task at different intervals.

- ***Active practice:*** 'Practice makes a man perfect': so said Bacon. To be a swimmer, you should plunge into water instead of simply reading about swimming or looking at films of the worlds' best swimmers. Learning is enhanced when trainees are provided ample opportunities to repeat the task. For maximum benefit, practice sessions should be distributed over time.
- ***Applicability of training:*** Training should be as real as possible so that trainees can successfully transfer the new knowledge to their jobs. The training situations should be set up so that trainees can visualise – and identify with – the types of situations they can come across on the job.
- ***Environment:*** Finally, environment plays a major role in training. It is natural that workers who are exposed to training in comfortable environments with adequate, well spaced rest periods are more likely to learn than employees whose training conditions are less than ideal. Generally, learning is very fast at the beginning. Thereafter, the pace of learning slows down as opportunities for improvement taper off.

8.10 EXECUTIVE DEVELOPMENT

Development is an education process as it tries to enhance one's ability to understand and interpret knowledge in a useful way. Development is different from training in that it is often the result of experience and the maturity that comes with it. It is possible to train most people to drive a vehicle, operate a computer, or assemble a radio. However, development in such areas as judging what is right or wrong, taking responsibility for results, thinking logically, understanding cause and effect relationships, synthesising experiences to visualise relationships, improving communication skills, etc., may or may not come through over time. Training certainly helps in improving these types of skills. But when the intent is to enhance executives' ability to handle diverse jobs and prepare them for future challenges, the focus must shift to executive development. Executive development focuses more on the manager's personal growth. It is more future oriented and more concerned with education than is employee training.

8.10.1 Definition

Executive or management development is a planned, systematic and continuous process of learning and growth by which managers develop

their conceptual and analytical abilities to manage. It is the result of not only participation in formal courses of instruction but also of actual job experience. It is primarily concerned with improving the performance of managers by giving them stimulating opportunities for growth and development.

8.10.2 Features of Executive Development

The prominent features of executive development are given as under:

- ***Planned effort:*** It is a planned effort to improve executives' ability to handle a variety of assignments. It helps executives handle tasks of increasing difficulty and scope in a competent way.
- ***Continuous learning process:*** It is not a one-shot deal, but a continuous, ongoing educational process. The learning on the part of executives is going to be broad and multifarious.
- ***Improve total personality of executive trainees:*** It aims at improving the total personality of an executive. The whole exercise is meant to help executives acquire competencies that could be put to effective use in a variety of situations. It aims at bringing about a relatively permanent change in the behaviours and attitudes of executives.
- ***Future-oriented:*** It aims at meeting future needs unlike training, which seeks to meet current needs. Executives are better equipped to handle complex jobs of increasing scope and difficulty in a variety of situations – once they complete the executive development programmes.
- ***Long-term educational exercise:*** It is a long-term educational process, as managers take time to acquire and improve their capabilities.
- ***Proactive in nature:*** It is proactive in nature as it focuses attention on the present as well as future requirements of both the organisation and the individual.

8.10.3 Importance

Executive development has become indispensable to modern organisations in view of the following reasons:

- ***Acquire knowledge and skills:*** For any business, executive development is an invaluable investment in the long run. It helps managers to acquire knowledge, skills and abilities (KSAs) required to grapple with complex changes in environment, technology and processes quite successfully. They can have a better grip over market forces and get ahead of others in the race in a confident manner.
- ***Realize potential:*** Developmental efforts help executives to realize their own career goals and aspirations in a planned way.
- ***Achieve superior performance:*** Executives can show superior performance on the job. By handling varied jobs of increasing difficulty and scope, they become more useful, versatile and productive. The

rich experience that they gain over a period of time would help them step into the shoes of their superiors easily.

- ***Broaden outlook:*** Executive development programmes help managers to broader their outlook, look into various problems dispassionately, examine the consequences carefully, appreciate how others would react to a particular solution and discharge their responsibilities taking a holistic view of the entire organisation.
- ***Know how to get things done:*** The special courses, projects, committee assignments, job rotation and other exercises help managers to have a feel of how to discharge their duties without rubbing people (subordinates, peers, superiors, competitors, customers, etc.) the wrong way.

Steps in the Organisation of a Management Development Programme

The following are the important steps in the organisation of a management development programme: (Noe; Wexley; Quinnones)

1. ***Analysis of organisational development needs:*** After deciding to launch a management development programme, a close and critical examination of the present and future development needs of the organisation has to be made. We should know how many and what type of managers are required to meet the present and future requirements.
2. A comparison of the already existing talents with those that are required to meet the projected needs will help the top management to take a policy decision as to whether it wishes to fill those positions from within the organisation or from outside sources.
3. ***Appraisal of present management talents:*** In order to make the above suggested comparison, a qualitative assessment of the existing executive talents should be made and an estimate of their potential for development should be added to that. Only then can it be compared with the projected required talents.
4. ***Inventory of management manpower:*** This is prepared to have a complete set of information about each executive in each position. For each member of the executive team, a card is prepared listing such data as name, age, length of service, education, work experience, health record, psychological test results and performance appraisal data, etc. The selection of individuals for a management development programme is made on the basis of the kind of background they possess.
5. Such information, when analysed, discloses the strengths as well as weaknesses or deficiencies of managers in certain functions relating to the future needs of the organisations.
6. ***Planning of individual development programmes:*** Guided by the results of the performance appraisal that indicates the strengths

and weaknesses of each of the executives, this activity of planning of individual development programme can be performed.

7. ***Establishment of development programmes:*** It is the duty of the HR department to establish the developmental opportunities. The HR department has to identify the existing level of skills, knowledge, etc., of various executives and compare them with their respective job requirements. Thus, it identifies developmental needs and requirements and establishes specific development programmes, like leadership courses, management games, sensitivity training, etc.
8. ***Evaluation of results:*** Executive development programmes consume a lot of time, money and effort. It is, therefore, essential to find out whether the programmes have been on track or not. Programme evaluation will cover the areas where changes need to be undertaken so that the participants would find the same to be relevant and useful for enriching their knowledge and experience in future. Opinion surveys, tests, interviews, observation of trainee reactions, rating of the various components of training, etc., could be used to evaluate executive development programmes.

SUMMARY

- Training is a planned programme designed to improve performance and to bring about measurable changes in knowledge, skills, attitude and social behaviour of employees.
- Training makes employees versatile, mobile, flexible and useful to the organisation. Development is future-oriented training, focusing on the personal growth of the employee.
- The various types of training include: skills training, refresher training, cross-functional training, team training, creativity training, diversity training, and literacy training.
- In order to have effective training programmes, a systematic approach – also known as the systems approach to training – needs to be put in place. The systems approach consists of four phases: needs assessment, setting training objectives, organisation and implementation of training programme and evaluation of results.
- Learning principles are the guidelines to the way people learn most effectively. More effective training incorporates more of these principles.
- Management development is the process in which executives acquire not only skills and competencies in their present jobs but also capabilities for future managerial tasks of increasing difficulty and scope.

- Management development, in contrast to employee training, is more future-oriented and concerned with education.

REVIEW QUESTIONS

1. What are the reasons for the growing usage of external training in present-day organisations?
2. What are the objectives of employee training? Explain the benefits of training.
3. What do you mean by 'training'? Distinguish between training, development and education.
4. Explain the various methods of training.
5. Distinguish between induction and training. Explain the importance of on-the-job training.

UNIT 9 CAREER PLANNING AND DEVELOPMENT

★ STRUCTURE ★

9.1 Introduction

9.2 Career Planning

9.3 Career Development

- Summary
- Review Questions

9.1 INTRODUCTION

Nowadays, employees have started demanding a rewarding career in place of a simple job. A secure job with time bound promotions would no longer satisfy the aspiring, young recruits. They want jobs with stretch, pull and challenge. They want excitement, psychic satisfaction, due recognition followed by appropriate rewards. They are not willing to take everything as it comes; instead they want to have a firm grip over their careers. They are willing to change hats, shift gears and do whatever possible to get what they want (*Carla Joinson, 2001*). Employee loyalty toward a particular organisation or a job seems to be a thing of the past. If the organisation does not offer rewarding growth opportunities, employees do not wish to spend their time just like that and become part of history. They are willing to go that extra mile in seeking jobs that are in sync with their competencies and skill sets. As a result, talented employees are likely to work in many different organisations during the course of their careers (unlike employees in yester years who used to work for only one organisation during their entire work life) Employers, too, are not taking any chances with people who lack enthusiasm, drive and energy to deliver results.

9.2 CAREER PLANNING

Career planning is the process by which one selects career goals and the path to these goals. The major focus of career planning is on assisting the employees achieve a better match between personal goals and the opportunities that are realistically available in the organisation.

- Career planning seeks to put an employee on path of career growth and success.

- Its focus is not on vertical growth of an employee. The focus is on fulfilling career aspirations of an employee and thereby achieve psychological fulfillment and success.
- Career planning is not an event or end in itself, but a continuous process of developing human resources for achieving optimum results.
- Career planning is a way of converting career goals into concrete action plans that are in sync with organisational goals.

9.2.1 Objectives

Career planning seeks to meet the following objectives:

1. Attract and retain talent by offering careers, not jobs.
2. Use human resources effectively and achieve greater productivity.
3. Reduce employee turnover.
4. Improve employee morale and motivation.
5. Meet the immediate and future human resource needs of the organisation on a timely basis.

9.2.2 Process

The career planning process involves the following steps:

(*a*) Identifying individual needs and aspirations: Most individuals do not have a clear cut idea about their career aspirations, anchors and goals. The human resource professionals must, therefore, help an employee by providing as much information as possible showing what kind of work would suit the employee most, taking his skills, experience, and aptitude into account. Such assistance is extended through workshops/seminars while the employees are subjected to psychological testing, simulation exercises, etc. The basic purpose of such an exercise is to help an employee form a clear view about what he should do to build his career within the company. Workshops and seminars increase employee interest by showing the value of career planning. They help employees set career goals, identify career paths and uncover specific career development activities (discussed later). These individual efforts may be supplemented by printed or taped information. To assist employees in a better way, organisations construct a data bank consisting of information on the career histories, skill evaluations and career preferences of its employees (known as skill or talent inventory).

(*b*) Analysing career opportunities: Once career needs and aspirations of employees are known, the organisation has to provide career paths for each position. Career paths show career progression possibilities clearly. They indicate the various positions that one could hold over a period of time, if one is able to perform well. Career paths change over time, of course, in tune with employee's needs and organisational requirements. While outlining career paths, the claims

of experienced persons lacking professional degrees and that of young recruits with excellent degrees but without experience need to be balanced properly.

(*c*) Aligning needs and opportunities: After employees have identified their needs and have realised the existence of career opportunities the remaining problem is one of alignment. This process consists of two steps: first, identify the potential of employees and then undertake career development programmes (discussed later on elaborately) with a view to align employee needs and organisational opportunities.

(*d*) Action plans and periodic review: The matching process would uncover gaps. These need to be bridged through individual career development efforts and organisation supported efforts from time to time. After initiating these steps, it is necessary to review the whole thing every now and then. This will help the employee know in which direction he is moving, what changes are likely to take place, what kind of skills are needed to face new and emerging organisational challenges. From an organisational standpoint also, it is necessary to find out how employees are doing, what are their goals and aspirations, whether the career paths are in tune with individual needs and serve the overall corporate objectives, etc.

9.3 CAREER DEVELOPMENT

Career development consists of the personal actions one undertakes to achieve a career plan. The terms 'career development' and 'employee development' need to be differentiated at this stage. Career development looks at the long-term career effectiveness of employees, whereas employee development focuses on effectiveness of an employee in the immediate future. The actions for career development may be initiated by the individual himself or by the organisation. These are discussed below (Bernardin; Knowdell; Lvowitz)

9.3.1 Individual Career Development

Career progress and development is largely the outcome of actions on the part of an individual. Some of the important steps that could help an individual cross the hurdles on the way 'up' may include:

(*a*) ***Performance:*** Career progress rests largely on performance. If the performance is sub-standard, even modest career goals can't be achieved.

(*b*) ***Exposure:*** Career development comes through exposure, which implies becoming known by those who decide promotions, transfers and other career opportunities. You must undertake actions that would attract the attention of those who matter most in an organisation.

(*c*) ***Networking:*** Networking implies professional and personal contacts that would help in striking good deals outside (e.g., lucrative job

offers, business deals, etc.). For years men have used private clubs, professional associations, old-boy networks, etc., to gain exposure and achieve their career ambitions.

(*d*) ***Leveraging:*** Resigning to further one's career with another employer is known as leveraging. When the opportunity is irresistible, the only option left is to resign from the current position and take up the new job (opportunity in terms of better pay, new title, a new learning experience, etc.). However, jumping too jobs frequently (job-hopping) may not be a good career strategy in the long run.

(*e*) ***Loyalty to career:*** Professionals and recent college graduates generally jump jobs frequently when they start their career. They do not think that career-long dedication to the same organisation may not help them further their career ambitions. To overcome this problem, companies such as Infosys, NIIT, WIPRO (all information technology companies where the turnover ratios are generally high) have come out with lucrative, innovative compensation packages in addition to employee stock option plans for those who remain with the company for a specified period.

(*f*) ***Mentors and sponsors:*** A mentor is, generally speaking, an older person in a managerial role offering informal career advice to a junior employee. Mentors take junior employees as their protégés and offer advice and guidance on how to survive and get ahead in the organisation. They act as role models. A sponsor, on the other hand, is someone in the organisation who can create career development opportunities.

(*g*) ***Key subordinates:*** Qualified and knowledgeable subordinates, often extend invaluable help that enables their bosses to come up in life. When the bosses cross the bridge, they take the key subordinates also along with them. In his own self interest, the subordinate must try to find that winning horse on which he can bet.

(*h*) ***Expand ability:*** Employees who are career conscious must prepare themselves for future opportunities that may come their way internally or externally by taking a series of proactive steps (e.g., attending a training programme, acquiring a degree, updating skills in an area, etc.).

9.3.2 Organisational Career Development

The assistance from managers and HR department is equally important in achieving individual career goals and meeting organisational needs. A variety of tools and activities are employed for this purpose *(Bernardin, pp. 350-356).*

(*a*) ***Self-assessment tools:*** Here the employees go through a process in which they think through their life roles, interests, skills and work attitudes and preferences. They identify career goals, develop suitable action plans and point out obstacles that come in the way. Two self-assessment tools are quite commonly used in organisations. The first one is called the career-planning workshop. After individuals

complete their self-assessments, they share their findings with others in career workshops. These workshops throw light on how to prepare and follow through individual career strategies. The second tool, called a career workbook, consists of a form of career guide in the question-answer format outlining steps for realising career goals. Individuals use this company specific, tailor-made guide to learn about their career chances. This guide, generally throws light on organisation's structure, career paths, qualifications for jobs and career ladders.

Career Self-assessment Instrument

Name ..... Age .....

Department .....

Part A: Values and Experience

1. Describe the roles in your life that are important to you (work life, family life, religious life, community life etc.) Explain why these roles are important to you. Indicates how these roles impact your total life satisfaction. Assign a per cent to each role (0 to 100 per cent) so that the total adds up to 100 per cent.
2. Describe your educational backgroun, including the degrees earned, academic strengths and weaknesses, extra curricular activities etc.

Degree/Diplomas	Academic Strengths/ Weaknesses	Academic Activities	Extracurricular
1	1	1	1
2	2	2	2
3	3	3	3

3. List any jobs you held your experience in each position

Occupation	Job	Degree of specialisation	What I Liked	What I Disliked	Why I Left
1.					
2.					
3.					
4.					
5.					

4. Describe any skills (rank 1 to 5 (lowest to highest) that you possess

(a) Communication	1	2	3	4	5
(b) Leadership	1	2	3	4	5
(c) Interpersonal	1	2	3	4	5
(d) Team building	1	2	3	4	5
(e) Creativity	1	2	3	4	5
(f) Technical	1	2	3	4	5

(Tick the most appropriate one)

5. Summarise any recognition/awards that you have received in relation to your education, work experience, skills or extra curricular activities.

Part B. Career Goals, Work Attitudes and Preferences

1. The most important needs I want to satisfy in my career are:
   a
   b
   c
2. These needs can be fulfilled in the following:

Areas	Skills/Assistance needed
a:	a:
b:	b:
c:	c:

3. How important are these values to you in your work (1 most important : 10 least important)

Values	Rank
1. Independence or autonomy	_
2. Financial rewards	_
3. Sense of achievement	_
4. Helping others	_
5. Creating something	_
6. Job security	
7. Good working conditions	_
8. Friendships at work	_
9. Variety of tasks	_
10. Equality and fairness	_

4. Whatever job I handle, I do not wish to compromise on the following:

1:	4:
2:	5:
3:	6:

5. What internal and external constraints might you encounter along the way toward achievement of your career goals?
6. List the specific jobs that might be in line with the above requirements:
   a
   b
   c
7. Finally, rate yourself on each of the following personal qualities or work characteristics. Write one response for each characteristic (using the following scale: 1. very low, 2. low, 3. average, 4. high, 5. very high)
   a. Emotional maturity
   b. Initiative/Independence
   c. Punctuality
   d. Ability to handle conflict
   e. Ability to plan, organise and determine work priorities
   f. Dependability in completing work
   g. Flexibility and open mindedness
   h. Perseverance/willingness to work
   i. Ability to set and achieve goals

(*b*) ***Individual counselling:*** Employee counselling is a process whereby employees are guided in overcoming performance problems. It is usually done through face-to-face meetings between the employee and the counsellor or coach. Here, discussions of employees' interests, goals, current job activities and performance and career objectives take place. Counselling is generally offered by the HR department. Sometimes outside experts are also be called in. If supervisors act as coaches they should be given clearly defined roles and training. This is, however, a costly and time consuming process.(Zunker)

(*c*) ***Information services:*** Employment opportunities at various levels are made known to employees through information services of various kinds. Records of employees' skills, knowledge, experience and performance indicate the possible candidates for filling up such vacancies. For compiling and communicating career-related information to employees, organisations basically use four methods:

- *Job posting system:* Job posting systems are used by companies to inform employees about vacancies in the organisation through notice boards, newsletters and other company publications.
- *Skills inventory:* Skills inventories (containing employees' work histories, qualifications, accomplishments, career objectives, geographical preferences, possible retirement dates, etc.) are created to help organisations learn the characteristics of their workforces so that they can use the skills of their employees, whenever required. Skills inventories also reveal shortage of critical skills among employees, which is helpful in tracing training needs.
- *Career ladders and career paths:* Career paths and ladders throw light on career progression and future job opportunities in the organisation. They indicate a career plan complete with the goal, intermediate steps and time-tables for realising the goal. Usually career paths for fast-track employees are laid down in most organisations outlining a series of career moves that these employees need to initiate in order to reach higher level positions.
- *Career resource centre:* The career centre is a sort of library in the organisation established to distribute career development materials such as reference books, career manuals, brochures, newsletters and learning guides and self-study tapes.

(*d*) ***Employee assessment programmes:*** New recruits receive orientation programme so that they can get along with work and colleagues. A senior employee generally assists them in getting used to the new work environment. In addition to this, special assessment programmes are put in place so as to find out the employees' potential for growth and development in the organisation. They include assessment centre, psychological testing, promotability forecasts and succession planning.

- *Assessment centres:* A number of performance simulation tests and exercises (tests, interviews, in-baskets, business games) are used to rate a candidate's potential in assessment centre method. The performance on these exercises is evaluated by a panel of raters and the candidates are given feedback on their strengths and weaknesses. This feedback helps participants to assess where they stand and what is to be done to scale the corporate ladder in future.
- *Psychological tests:* Diagnostic tests are used to help candidates determine their vocational interests, personality types, work attitudes and other personal characteristics that may uncover their career needs and preferences.
- *Promotability forecasts:* This is a process of identifying employees with high career potential and giving them necessary training and thereby groom them for higher positions.
- *Succession planning:* This is a report card showing which individuals are ready to move into higher positions in the company. The HR department keeps records of all potential candidates who could move into senior positions, whenever required.

(e) ***Employee developmental programmes:*** These consist of skill assessment (explained above) and training efforts that organisations use to groom their employees for future vacancies. Seminars, workshops, job rotations and mentoring programmes are used to develop a broad base of skills as a part of such developmental activities.

(f) ***Career programmes for special groups:*** To take care of the needs of special groups such as dual career couples especially in knowledge based industries (a situation where both husband and wife have distinct careers outside the home) companies are coming out with schemes such as part-time work, long parental leave, child care centres, flexible working hours and promotions and transfers in tune with the demands of dual career conflicts. Outplacement assistance is extended to employees who are laid off for various reasons. In addition to holding workshops, outside experts are called in to show individuals how to focus on their talents, develop resumes and interview with prospective employers. Special programmes are also organised for minorities, employees with disabilities, women and late-career employees so that they can have clear career goals and action plans in line with organisational requirements.

9.3.3 Effective Career Planning

It's clear from the above table that systematic career planning efforts offer innumerable benefits to both the individuals and organisations. To ensure success here, a number of steps should be taken.

(a) ***Support:*** Career planning efforts must receive consistent support and continued blessings from the top management.

(b) ***Goals:*** The corporate goals must be laid down clearly. It is not possible to develop appropriate goals for human resources if you are not very sure about your journey in the next 5 or 10 years.

(c) ***Reward performance:*** Employees must be willing to expand their abilities; trainers must be willing to coach, counsel and share their knowledge with employees. There must be appropriate rewards for people from both sides who show promise.

(d) ***Placement:*** Every effort must be made to put employees on jobs that are in tune with their capabilities. If a talented employee is put on a routine job, he will quit in frustration.

(e) ***Career paths:*** The career paths for different types of employees must be laid down clearly. Fast track promotions should be available to talented people, seniors could be used on jobs requiring experience and judgement, juniors could be used for jobs that demand routine application of rules and procedures, etc.

(f) ***Continuous tracking:*** Career planning efforts should be carried out on a continuing basis keeping the changing needs of employees and the organisation in mind. A record of career movements of employees must be kept and periodic assessment of who has gone where should be made.

(g) ***Publicity:*** Everyone should be aware of the career opportunities within the organisation.

SUMMARY

- Career planning is the process by which one selects career goals and the path to these goals. Career planning is not a sure bet, but without it, employees are seldom ready for the career opportunities that arise.
- Career development is a lifelong process of understanding your career preferences; identifying, obtaining and developing appropriate skills and training for that career and continually evaluating your career preferences and skills over your working life to find whether they continue to meet your needs and those of the organisation.
- Career development could occur at the individual or the organisational level. Individuals can push up their careers through performance, exposure, networking, leveraging, etc. Important organisational career development techniques include career counselling, job postings, assessment centres, career development workshops, periodic job changes, etc.

REVIEW QUESTIONS

1. What is career planning? Outline the process of career planning clearly.
2. Examine the need for career planning from the point of view of an individual employee and the organisation.
3. What is career development? Explain the process of career development clearly.
4. Suppose you are assigned to develop a career planning and development programme in a large organisation with a diverse workforce. What unique concerns might you have because of this diversity?

CASE STUDY: Unfair Promotion

Electronic Industries Ltd, Faridabad is producing electric bulbs, water coolers, air coolers and refrigerators. Recently, it added a new line of production, i.e., electric motors both for domestic and agricultural purposes. It needed one electric engineer with B. Tech qualification to look after the new plant producing electric motors. Presently, five electric engineers with B.E. qualification are working as Assistant Engineers in the existing plant. The company advertised for the post of Chief Engineer (Electrical) for its new plant. It received twelve applications out of which five are Assistant Engineers working in the existing plant.

The company used techniques of preliminary interviews, tests, final interview and medical examination and finally selected Mr Anil Ambani, employed in the existing plant of the company. He is fourth in the seniority list of the Assistant Engineers in the present plant. The company served the appointment order to Mr Ambani and he joined as Chief Engineer in the new plant. But the three Assistant Engineers in the existing plant moved the issue to the court of law contesting that the selection of Mr Ambani is not valid as he does not have seniority among the Assistant Engineers in the existing plant.

Questions

1. Comment on the managerial choice in favour of Mr Ambani.
2. Is it necessary to promote only seniors to higher posts in an organisation? Why? Why not?
3. What is the legal position in such cases in India?

UNIT 10 PERFORMANCE AND POTENTIAL APPRAISAL

★ STRUCTURE ★

10.1 Performance Appraisal: Meaning and Purpose
10.2 Features
10.3 Objectives
10.4 Performance Appraisal Process
10.5 Methods of Performance Appraisal
10.6 360-Degree Appraisal System
10.7 An Effective Appraisal System
10.8 Potential Appraisal
- Summary
- Review Questions

10.1 PERFORMANCE APPRAISAL: MEANING AND PURPOSE

After an employee has been selected for a job, has been trained to do it and has worked on it for a period of time, his performance should be evaluated. Performance evaluation or appraisal is the process of deciding how employees do their jobs. Performance here refers to the degree of accomplishment of the tasks that make up an individual's job. It indicates how well an individual is fulfilling the job requirements.

Performance appraisal is a method of evaluating the behaviour of employees in the work spot, normally including both the quantitative and qualitative aspects of job performance. It is a systematic and objective way of evaluating both work-related behaviour and potential of employees. It is a process that involves determining and communicating to an employee how he or she is performing the job and ideally, establishing a plan of improvement.

10.2 FEATURES

The main characteristics of performance appraisal may be listed thus:

- ***Systematic Process:*** The appraisal is a systematic process that tries to evaluate performance in the same manner using the same approach. A number of steps are followed to evaluate an employee's strengths and weaknesses.

- ***Picture of employee strengths and weaknesses:*** It provides an objective description of an employee's job-relevant strengths and weaknesses.
- ***Indicates how well X is doing on the job:*** It tries to find out how well the employee is performing the job and tries to establish a plan for further improvement.
- ***Not a one-shot deal:*** The appraisal is carried out periodically, according to a definite plan. It is certainly not a one-shot deal.
- ***It is different from Job evaluation:*** Performance evaluation is not job evaluation. Performance appraisal refers to how well someone is doing an assigned job. Job evaluation, on the other hand, determines how much a job is worth to the organisation, and therefore, what range of pay should be assigned to the job.
- ***It may be formal or informal:*** Performance appraisal may be formal or informal. The informal evaluation is more likely to be subjective and influenced by personal factors. Some employees are liked better than others and have, for that reason only, better chances of receiving various kinds of rewards than others. The formal system is likely to be more fair and objective, since it is carried out in a systematic manner, using printed appraisal forms.

10.3 OBJECTIVES

The main objectives of performance appraisal may be listed thus:

- Offer feedback on performance to employees.
- Identify employee training needs.
- Document criteria used to allocate organisational rewards.
- Form a basis for personnel decisions such as salary increases, promotions and disciplinary actions.
- Provide the opportunity for organisational diagnosis and development.
- Facilitate communication between employee and administrator.
- Validate selection techniques and human resource policies to meet federal equal employment opportunity requirements.

10.4 PERFORMANCE APPRAISAL PROCESS

Performance appraisal is planned, developed and implemented through a series of steps.

- ***Establish performance standards:*** Appraisal systems require performance standards, which serve as benchmarks against which performance is measured. To be useful, standards should relate to

the desired results of each job. Both the appraiser and the appraise must have a clear idea about the standards to be met.

- ***Communicate the standards:*** Performance appraisal involves at least two parties; the appraiser who does the appraisal and the appraisee whose performance is being evaluated. Both are expected to do certain things. The appraiser should prepare job descriptions clearly; help the appraisee set his goals and targets; analyse results objectively; offer coaching and guidance to the appraisee whenever required and reward good results. The appraisee should be very clear about what he is doing and why he is doing it. For this purpose, performance standards must be communicated to appraisees and their reactions should be noted down right away. If necessary, these standards must be revised or modified.
- ***Measure actual performance:*** After the performance standards are set and accepted, the next step is to measure actual performance. This requires the (i) use of appropriate technique of measurement, (ii) understanding the factors that affect performance and (iii) obtaining information on results achieved. Factors like experience, individual judgement, personal observation and written reports help the appraisers get the requisite information.
- ***Compare actual performance with standards and discuss the appraisal:*** Actual performance may be better than expected and sometimes it may go off the track. Whatever the consequences, there is a way to communicate and discuss the final outcome. The assessment of another person's contribution and ability is not an easy task. It has serious emotional overtones as it affects the self-esteem of the appraisee. Any appraisal based on subjective criteria is likely to be questioned by the appraisee and leave him quite dejected and unhappy when the appraisal turns out to be negative.
- ***Taking corrective action:*** Corrective action is of two types: one puts out the fires immediately, while the other destroys the root of the problem permanently. Immediate action sets things right and get things back on track whereas the basic corrective action gets to the source of deviations and seeks to adjust the difference permanently. Basic corrective steps seek to find out how and why performance deviates.

10.5 METHODS OF PERFORMANCE APPRAISAL

The performance appraisal methods may be classified into three categories, as shown below:

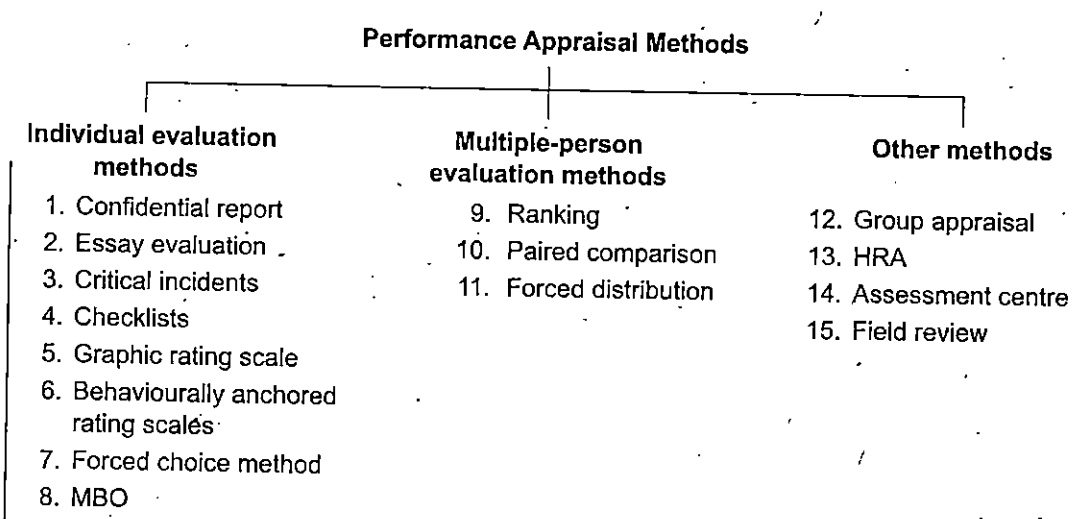

Fig. 10.1 Performance Appraisal Methods

10.5.1 Individual Evaluation Methods

Under the individual evaluation methods of merit rating, employees are evaluated one at a time without comparing them with other employees in the organisation.

Confidential Report

It is mostly used in government organisations. It is a descriptive report prepared, generally at the end of every year, by the employee's immediate superior. The report highlights the strengths and weaknesses of the subordinate. The report is not databased. The impressions of the superior about the subordinate are merely recorded there. It does not offer any feedback to the appraisee. The appraisee is not very sure about why his ratings have fallen despite his best efforts, why others are rated high when compared to him, how to rectify his mistakes, if any; on what basis he is going to be evaluated next year, etc. Since the report is generally not made public and hence no feedback is available, the subjective analysis of the superior is likely to be hotly contested. In recent years, due to pressure from courts and trade unions, the details of a negative confidential report are given to the appraisee.

Essay Evaluation

Under this method, the rater is asked to express the strong as well as weak points of the employee's behaviour. It is a non-quantitative technique. This method is advantageous in at least one sense, i.e., the essay provides a good deal of information about the employee and also reveals more about the evaluator. The essay evaluation method, however, suffers from the following limitations:

- It is highly subjective; the supervisor may write a biased essay. The employees who are sycophants will be evaluated more favourably than other employees.
- Some evaluators may be poor in writing essays on employee performance. Others may be superficial in explanation and use flowery language

which may not reflect the actual performance of the employee. It is very difficult to find effective writers.

- The appraiser is required to find time to prepare the essay. A busy appraiser may write the essay hurriedly without properly assessing the actual performance of the worker. On the other hand, appraiser takes a long time, this becomes uneconomical from the view point of the firm, because the time of the evaluator (supervisor) is costly.

Critical Incident Technique

Under this method, the manager prepares lists of statements of very effective and ineffective behaviour of an employee. These critical incidents or events represent the outstanding or poor behaviour of employees or the job. The manager maintains logs of each employee, whereby he periodically records critical incidents of the workers behaviour. At the end of the rating period, these recorded critical incidents are used in the evaluation of the worker's performance. Example of a good critical incident of a Customer Relations Officer is: 'June 10 – The officer processed complaints from customer patiently. He was polite in his replies and prompt in resolving the knotty issues. He showed maturity and emotional balance while handling angry protests from customers.' This method provides an objective basis for conducting a thorough discussion of an employee's performance. This method avoids recency bias (most recent incidents get too much emphasis). However, it suffers from the following limitations:

- Negative incidents may be more noticeable than positive incidents.
- The supervisors have a tendency to unload a series of complaints about incidents during an annual performance review session.
- It results in very close supervision which may not be liked by the employee.
- The recording of incidents may be a chore for the manager concerned, who may be too busy or forget to do it.

Most frequently, the critical incidents method is applied to evaluate the performance of superiors.

Checklists and Weighted Checklists

Another simple type of individual evaluation method is the checklist. A checklist represents, in its simplest form, a set of objectives or descriptive statements about the employee and his behaviour. If the rater believes strongly that the employee possesses a particular listed trait, he checks the item; otherwise, he leaves the item blank. A more recent variation of the checklist method is the weighted list. Under this, the value of each question may be weighted equally or certain questions may be weighted more heavily than others. The following are some of the sample questions in the checklist.

- Is the employee really interested in the task assigned? Yes/No

- Is he respected by his colleagues (co-workers)? Yes/No
- Does he give respect to his superiors? Yes/No
- Does he follow instructions properly? Yes/No
- Does he make mistakes frequently? Yes/No

A rating score from the checklist helps the manager in evaluation of the performance of the employee. The checklist method has a serious limitation. The rater may be biased in distinguishing the positive and negative questions. He may assign biased weights to the questions. Another limitation could be that this method is expensive and time consuming. Finally, it becomes difficult for the manager to assemble, analyse and weigh a number of statements about the employee's characteristics, contributions and behaviours.

Graphic Rating Scale

Graphic rating scales require an evaluator to indicate on a scale the degree to which an employee demonstrates a particular trait, behaviour, or performance result. Rating forms are composed of a number of scales, each relating to a certain job or performance-related dimension, such as job knowledge, responsibility, or quality of work. Each scale is a continuum of scale points, which range from high to low, from good to poor, from most to least effective, and so forth. Scales typically have from five to seven points. Graphic rating scales may or may not define their scale points. The rating scale that is shown below measures two things: quantity of work and quality of work.

Typical Graphic Rating Scale

Employee name	Job Title
Department	Rate
Date	
Unsatisfactory Fair Satisfactory Good Outstanding	
Quantity of work	
Quality of work	
Knowledge of the job	
Attitude	
Dependability	
Cooperation	

Carefully constructed graphic rating scales have a number of advantages:

- Standardisation of content permitting comparison of employees.
- Ease of development use and relatively low development and usage cost
- Reasonably high rater and ratee acceptance.

A weak spot in such rating scales is that they are susceptible to rating errors which result in inaccurate appraisals. Possible rating errors include

halo effect, central tendency, severity, and leniency. The halo effect occurs when a rating on one dimension of an appraisal instrument substantially influences the ratings on other dimensions for the same employee. As a result of the halo effect, an employee is rated about the same across all performance dimensions. Central tendency is a lack of variation or difference among ratings of different subordinates, wherein most employees tend to be rated as average. Leniency refers to an evaluator's tendency to rate most employees very highly across performance dimensions, whereas severity refers to the tendency to rate most employees quite harshly.

Behaviourally Anchored Rating Scales (BARS)

It is a combination of the rating scale and critical incident techniques of employee performance evaluation. The critical incidents serve as anchor statements on a scale and the rating form usually contains six to eight specifically defined performance dimensions. It consists of predetermined critical areas of job performance or sets of behavioural statements describing important job performance qualities as good or bad (for example, qualities like inter-personal relationships, adaptability, reliability, and job knowledge). These statements are developed from critical incidents. In this method, an employee's actual job behaviour is judged against the desired behaviour by recording and comparing the behaviour with BARS. Developing and practicing BARS requires considerable skills and expert knowledge.

Evaluation: The ratings are fairly accurate since they are carried out by experts. Since job-specific factors are observed and measured, the ratings are more reliable. Employees tend to accept them readily since they have participated in the process. The method allows participants learn from the feedback and grow. The method, however, suffers from the following disadvantages:

- Requires observational skill and proper determination of critical behaviours; inadequacies can lead to misleading data.
- Compilation of critical behaviours takes considerable time and effort, and recording data also involve alert and constant observations (i.e. keeping logs).
- Less preferable due to similarity to trait measures.

Forced Choice Method

This method was developed to eliminate bias and the preponderance of high ratings that might occur in some organisations. The primary purpose of the forced choice method is to correct the tendency of a rater to give consistently high or low ratings to all the employees. This method makes use of several sets of pair phrases, two of which may be positive and two negative and the rater is asked to indicate which of the four phrases is the most and least descriptive of a particular worker. Actually, the statement items are grounded in such a way that the rater cannot easily judge which statements apply to the most effective employee. The following is a classic illustration of the forced choice items in organisations.

Forced Choice Items

1.	Least		Most
	A	Does not anticipate difficulties	A
	B	Grasps explanations easily and quickly.	B
	C	Does not waste time	C
	D	Very easy to talk to	D
2.	Least		Most
	A	Can be a leader	A
	B	Wastes time on unproductive things	B
	C	At all times, cool and calm	C
	D	Smart worker	D

The favourable qualities earn a plus credit and the unfavourable ones earn the reverse. The worker gets over plus when the positive factors override the negative ones or when one of the negative phrases is checked as being insignificantly rated. The overall objectivity is increased by using this method in evaluation of employee's performance, because the rater does not know how high or low he is evaluating the individual as he has no access to the scoring key. This method, however, has a strong limitation. In the preparation of sets of phrases trained technicians are needed and as such the method becomes very expensive. Further, managers may feel frustrated rating the employees 'in the dark'. Finally, the results of the forced choice method may not be useful for training employees because the rater himself does not know how he is evaluating the worker. In spite of these limitations, the forced choice technique is quite popular.

Management by Objectives

Management by objectives (MBO) (also called 'appraisal by result', 'planning by objectives, 'goal management', 'work planning and review', 'joint target setting' etc.) is an overall philosophy of management that concentrates on measurable goals and end results. It provides a systematic and rational approach to management and helps prevent management by crisis. MBO is based on the assumption that people perform better when they know what is expected of them and can relate their personal goals to the organisational objectives. It also assumes that people are interested in the goal-setting process and in evaluating their performances against the target. In the words of Odiorne, MBO is a 'process whereby the superior and subordinate managers of an organisation jointly identify its common goals, define each individual's major areas of responsibility in terms of results expected of him, and use these measures as guides for operating the unit and assessing the contribution of each of its members' Important features of this method may be listed thus:

- ***Joint goal setting:*** MBO requires the superior and the subordinate to recognize that the development of objectives is a joint effort. They must be jointly agree and write out their duties and areas of responsibility in their respective jobs.

- ***Quantifiable goals:*** MBO is all about goals that are tangible, verifiable and measurable. The subordinate in consultation with his superior sets his own short-term goals – that are realistic and attainable.
- ***Focus on goal achievement:*** MBO focuses special attention on what must be accomplished (goals) rather than how it is to be accomplished (methods). The superior and the subordinate mutually find out ways and means to achieve the goals that are mutually agreed upon. They mutually set the standards to be followed and decide the norms for evaluating performance.
- ***Effective results:*** MBO paves the way for the attainment of goals by putting resources to best use – with a single minded focus on attainable goals. Subordinates are allowed to think creatively and meet targets. When everyone is aware of what needs to achieved and how the performances is going to be evaluated and rewarded – the end result is superior performance.
- ***Consistent support and continued blessings from superior:*** Superiors extend their help whenever and wherever needed. They offer necessary coaching and guidance from time to time. They keep all communication lines open. The whole focus is on getting results, through mutual support, help and cooperation.

10.5.2 Multiple-Person Evaluation Techniques

The above discussed methods are used to evaluate employees one at a time. In this section let us discuss some techniques of evaluating one employee in comparison to another. Three such frequently used methods in organisation are – ranking, paired comparison and forced distribution.

Ranking Method

This is a relatively easy method of performance evaluation. Under this method, the ranking of an employee in a work group is done against that of another employee. The relative position of each employee is tested in terms of his numerical rank. It may also be done by ranking a person on his job performance against another member of the competitive group. The quintessence of this method is that employees are ranked according to their levels of performance. While using this method, the evaluator is asked to rate employees from highest to lowest on some overall criterion. Though it is relatively easier to rank the best and the worst employees, it is very difficult to rank the average employees. Generally, evaluators pick the top and bottom employees first and then select the next highest and next lowest and move towards the average (middle) employees. The major limitations of this method are:

- The 'whole man' is compared with another 'whole man' in this method. In practice, it is very difficult to compare individuals possessing varied behavioural traits.

- This method speaks only of the position where an employee stands in his group. It does not tell anything about how much better or how much worse an employee is when compared to another employee.
- When a large number of employees are working, ranking of individuals becomes a painstaking issue.
- There is no systematic procedure for ranking individuals in the organisation. The ranking system does not eliminate the possibility of snap judgements.

In order to overcome the above limitations a paired comparison technique has been advanced by organisational scholars.

Paired Comparison Method

Ranking becomes more reliable and easier under the paired comparison method. Each worker is compared with all other employees in the group; for every trait the worker is compared with all other employees. For instance, when there are five employees to be compared, then A's performance is compared with that of B's and decision is arrived at as to who is the better or worse. Next, B is also compared with all others. Since A is already compared with B, this time B is to be compared with only C, D and E. By this method when there are five employees, fifteen decisions are made (comparisons). The number of decisions to be made can be determined with the help of the formulae n (n-2). For several individual traits, paired comparisons are made, tabulated and then rank is assigned to each worker. Though this method seems to be logical, it is not applicable when a group is large. When the group becomes too large, the number of comparisons to be made may become frighteningly excessive. For instance, when n=100, comparisons to be made are 100 (100-2) = 100 (98) = 9800.

Forced Distribution Method

Under this system, the rater is asked to appraise the employee according to a predetermined distribution scale. The rater's bias is sought to be eliminated here because workers are not placed at a higher or lower end of the scale. Normally, the two criteria used here for rating are the job performance and promotability. Further, a 5-point performance scale is used without any mention of descriptive statements. Workers are placed between the two extremes of 'good' and 'bad' performances. For instance, workers of outstanding merit may be placed at the top 10 per cent of the scale; 20 per cent may be given good rating (i.e. above average); 40 per cent satisfactory (or average); 20 per cent fair and 10 per cent unsatisfactory (below average or poor) Apart from job performance as the criterion, another equally important factor in this method is promotability. Employees may be classified according to their promotional merits. The scale for this purpose may consist of three points – namely, quite likely promotional material, may/may not be promotional material and quite unlikely promotional material. One strong positive point in favour of the forced distribution method is that by forcing the distribution according to

predetermined percentages, the problem of making use of different raters with different scales is avoided. Further, this method is appreciated on the ground that it tends to eliminate rater bias. The limitation of using this method in salary administration, however, is that it may result in low morale, low productivity and high absenteeism. Employees who feel that they are productive, but find themselves placed in a lower grade (than expected) feel frustrated and exhibit, over a period of time, reluctance to work.

10.5.3 Other Methods

Other methods of appraising performance include: Group Appraisal, Human Resource Accounting, Assessment Centre, Field Review, etc. These are discussed in the following sections:

Group Appraisal

In this method, an employee is appraised by a group of appraisers. This group consists of the immediate supervisor of the employee, other supervisors who have close contact with the employee's work, manager or head of the department and consultants. The head of the department or manager may be the Chairman of the group and the immediate supervisor may act as the Coordinator for the group activities. This group uses any one of multiple techniques discussed earlier. The immediate supervisor enlightens other members about the job characteristics, demands, standards or performance, etc. Then the group appraises the performance of the employee, compares the actual performance with standards, finds out the deviations, discusses the reasons therefore, suggests ways for improvement of performance, prepares an action plan, studies the need for change in the job analysis and standards and recommends changes, if necessary. This method eliminates 'personal bias' to a large extent, as performance is evaluated by multiple rates. But it is a very time-consuming process.

Human Resource Accounting

It is the process of accounting for people as an organisational resource. It tries to place a value on organisational human resources as assets and not as expenses. The HRA process shows the investment the organisation makes in its people and how the value of these people changes over time. The acquisition cost of employees is compared to the replacement cost from time to time. The value of employees is increased by investments made by the company to improve the quality of its human resources such as training and development skills acquired by employees over a period of time through experience. When qualified, competent people leave an organisation, the value of human assets goes down. In this method, employee performance is evaluated in terms of costs and contributions of employees. Human resource costs include expenditure incurred by the company in hiring, training, compensating and developing people. The contributions of human resources is the money value of labour productivity. The cost of human resources may

be taken as the standard. Employee performance can be measured in terms of employee contribution to the organisation. Employee performance can be taken as positive when contribution is more than the cost and performance can be viewed as negative if cost is more than contribution. Positive performance can be measured in terms of percentage of excess of employee contribution over the cost of employee. Similarly, negative performance can be calculated in terms of percentage of deficit in employee contribution compared to the cost of employee.

Assessment Centre

This method of appraising was first applied in the German Army in 1930. Later, business and industrial houses started using this method. This is not a technique of performance appraisal by itself. In fact it is a system in which several individuals are assessed by experts using various techniques. These techniques include the methods discussed before, in addition to in-basket, role playing, case studies, simulation exercises, structured in sight and transactional analysis.

In this approach individuals from various departments are brought together to spend two or three days working on an individual or group assignment similar to the ones they would be handling when promoted. Observers rank the performance of each and every participant in order of merit. Since assessment centres are basically meant for evaluating the potential of candidates to be considered for promotion, training or development, they offer an excellent means for conducting evaluation processes in an objective way. All those assessed get an equal opportunity to show their talents and capabilities and secure promotion based on merit. Since evaluators know the position requirements intimately and are trained to perform the evaluation process in an objective manner, the performance ratings may find favour with majority of the employees. A considerable amount of research evidence is available to support the contention that people chosen by this method prove better than those chosen by other methods. The centre enables individuals working in low-status departments to compete with people from high-profile departments and enhance their chances of promotion. Such opportunities, when created on a regular basis, will go a long way in improving the morale of promising candidates working in less important positions.

Field Review Method

Where subjective performance measures are used, there is scope for rater's biases influencing the evaluation process. To avoid this, some employees use the field review method. In this method a trained, skilled representative of the HR department goes into the 'field' and assists line supervisors with their ratings of their respective subordinates. The HR specialist requests from the immediate supervisor specific information about the employees performance. Based on this information, the expert prepares a report which

is sent to the supervisor for review, changes, approval and discussion with the employee who is being rated. The ratings are done on standardized forms. Since an expert is handling the appraisal process in consultation with the supervisor, the ratings are more reliable. However, the use of HR experts makes this approach costly and impractical for many organisations.

10.6 360-DEGREE APPRAISAL SYSTEM

360-degree appraisal is a system or process in which employees receive confidential, anonymous feedback from the people who work around them. The inputs for the said appraisal are provided by subordinates, peers, superiors, team members, customers, suppliers and anyone who works closely with the employee (whose performance is evaluated by multiple raters) in question. The appraisal measures behaviours and competencies exhibited by the ratee over a period of time. The skills that are being appraised include listening, planning and goal setting. Other aspects of behaviour such as teamwork, leadership and effectiveness are also assessed. The responses from different raters (subordinate's appraisal, peer appraisal, superior's appraisal along with self appraisal) are combined to obtain an objective assessment of the ratee's performance and behaviours. The feedback could be brutally frank – but reliable and credible – since it is obtained in an anonymous manner. As such, the quality of information obtained tends to be high. There is less scope for individual bias or prejudice coming in the way of an unbiased assessment.

The emerging discrepancies between an employee's self-appraisal and the appraisals from others could be put to close examination. Such a probing exercise could uncover gaps and help the ratee to cover them up through efforts aimed at self growth and self development. Not surprisingly, over 90 per cent of Fortune 500 companies have implemented some form of 360-degree feedback system for career development, performance appraisal, or both. Organisations like NTPC, State Bank of India, Titan Industries, Bajaj Auto, Dr. Reddy's Laboratories have reposed their faith in the 360-degree appraisals and have been using these increasingly in recent times. The method is highly popular in almost all leading IT companies, including the likes of Infosys, Wipro, TCS and KPMT Cummins.

10.7 AN EFFECTIVE APPRAISAL SYSTEM

An effective appraisal system should possess the following essential characteristics:

- ***Reliability and validity:*** Appraisal system should provide consistent, reliable and valid information and data, which can be used to defend the organisation, even in legal challenges. If two appraisers are equally qualified and competent to appraise an employee with the help of the same appraisal technique, their ratings should agree with each other. Then the technique satisfies the conditions of inter-rater

reliability. Appraisals must also satisfy the condition of validity by measuring what they are supposed to measure. For example, if an employee is appraised with the object of promotion, information related to his potentialities to take up higher responsibilities and carry on activities at higher level should be supplied.

- ***Job relatedness:*** The appraisal technique should measure the performance and provide information in job-related activities/areas.
- ***Standardization:*** Appraisal forms, procedures, administration of techniques, ratings, etc., should be standardized as appraisal decisions affect all employees of the group.
- ***Practical viability:*** The techniques should be practically viable to administer, possible to implement and economical to undertake continuously.
- ***Legal sanction:*** Appraisals must meet the laws of the land. They must comply with provisions of various acts relating to labour.
- ***Training to appraisers:*** Because appraisal is important and sometimes difficult, it would be useful to provide training to appraisers viz., some insights and ideas on rating, documenting appraisals and conducting appraisal interviews. Familiarity with rating errors can improve rater's performance and this may inject the needed confidence in appraisers to look into performance ratings more objectively.
- ***Open communication:*** Most employees want to know how well they are performing the job. A good appraisal system provides the needed feedback on a continual basis. The appraisal interviews should permit both parties to learn about the gaps and prepare themselves for future. To this end, managers should clearly explain their performance expectations to their subordinates in advance of the appraisals period. Once this is known, it becomes easy for employees to learn about the yardsticks and, if possible, try to improve their performance in future.
- ***Employee access to results:*** Employees should know the rules of the game. They should receive adequate feedback on their performance. If performance appraisals are meant for improving employee performance, then withholding appraisal result would not serve any purpose. Employees simply cannot perform better without having access to this information. Permitting employees to review the results of their appraisal allows them to detect any errors that may have been made. If they disagree with the evaluation, they can even challenge the same through formal channels.
- ***Due process:*** It follows then that formal procedures should be developed to enable employees who disagree with appraisal results (which are considered to be inaccurate or unfair). They must have the means for pursuing their grievances and having them addressed objectively.

- Performance appraisal should be used primarily to develop employees as valuable resources. Only then it would show promising results. When management uses it as a whip or fails to understand its limitations, it fails. The key is not which form or which method is used (*Mathis and Jackson 2015*).

10.8 POTENTIAL APPRAISAL

In most Indian organisations, people earn promotions on the basis of their past performance, which is considered a good indicator of future job success. This could be true, if the job to be performed by the promotee is similar. However, in actual practice, the roles that a person played in the past may not be the same as the one(s) he is expected to play if he is assigned a different job after his transfer or promotion to a new position. Past performance, therefore, may not be a good indicator of the suitability for a higher role. To overcome this inadequacy, organisations must think of a new system called potential appraisal. Potential typically represents latent qualities (such as ability foresee opportunities and their impact on current decisions, ability to identify resource gaps, ability to perform tasks in a tough setting, ability to function in diverse settings with confidence, ability to see the big picture clearly; displaying a high degree of personal and intellectual integrity at all times) exhibited by an individual while performing various tasks/jobs (Pattanayak, 2008, 137-140). The objective of potential appraisal is to identify the potential of a given employee to occupy higher positions in the organisational hierarchy and undertake higher responsibilities (Pareek, p.141). Potential appraisals are required to:

- inform employees about their future prospects;
- help the organisation chalk out a suitable succession plan;
- update training efforts from time to time;
- advise employees about what they must do to improve their career prospects.

Essentials of a Good Potential Appraisal System

The following are some of the steps required to be followed while introducing a potential appraisal system:

Role descriptions: Organisational roles and functions must be defined clearly. To this end, job descriptions must be prepared for each job.

Qualities needed to perform the roles: Based on job descriptions, the roles to be played by people must be prepared (i.e., technical, managerial jobs and behavioural dimensions).

Rating mechanisms: Besides listing the functions and qualities, the potential appraisal system must list mechanisms of judging the qualities of employees such as:

- *Rating by others:* The potential of a candidate could be rated by the immediate supervisor who is acquainted with the candidate's work in the past, especially his technical capabilities.

- *Tests:* Managerial and behavioural dimensions can be measured through a battery of psychological tests.
- *Games:* Simulation games and exercises (assessment centre, business games, in-basket, role play, etc.) could be used to uncover the potential of a candidate.
- *Records:* Performance records and ratings of a candidate on his previous jobs could be examined carefully on various dimensions such as initiative, creativity, risk taking ability, etc., which might play a key role in discharging his duties in a new job.

Organizing the system: After covering the above preliminaries, the HR manager must set up a system that will allow the introduction of the scheme smoothly incorporating answers to some complex questions such as:

- How much weightage to accord to merit in place of seniority in promotions?
- How much weightage to accord to each of the performance dimensions – technical, managerial, behavioural qualities?
- What are the mechanisms of assessing the individual on different indicators of his potential, and with what degree of reliability?

Feedback: The system must provide an opportunity for every employee to know the results of his assessment. "He should be helped to understand the qualities actually required for performing the role for which he thinks he has the potential, the mechanisms used by the organisations to appraise his potential and the results of such an appraisal."

How do Leading Indian Companies Appraise Potential?

Leading Indian companies like Philips, Glaxo, Cadbury, Sandoz, Pfizer, Mafatlal, Proctor and Gamble have all redesigned their systems in recent times, shifting from a pure performance orientation to a potential-cum-performance based appraisal system. The Philips model, in this connection, is worth mentioning, shown below in Fig. 10.2 here. (Modak)

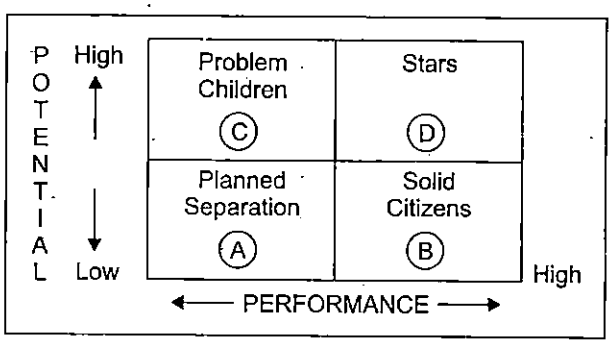

Fig. 10.2 HRM as a Central Sub-system in an Enterprise.

(*a*) ***Low potential-low performance:*** Employees with low potential and low performance levels ('question marks') are asked to improve their performance initially. If that effort fails, Philips works towards a planned separation.

(b) ***Low potential-high performance:*** Defined as solid citizens – high skills but limited capability to grow beyond their current job profile – they constitute 70 to 75 per cent of the company's employees. The company has to constantly recognise their limitations and look after their needs.

(c) ***Low performance-high potential:*** These are the problem children. In most cases, they do well in their jobs – if a location, boss or job profile is changed. To tap their potential, such employees are given a new scenario to work in and are closely observed. If they continue to show low performance, the separation process is initiated.

(d) ***High performance-high potential:*** They are the star performers and ought to be pampered like race horses – putting them on challenging tasks constantly.

Philips uses a five-point scale to measure the potential of an employee and put him into one of the above quadrants. The potential appraisal criteria include the following:

1. Conceptual effectiveness (including vision, business orientation, entrepreneurial orientation, sense of reality),
2. Interpersonal effectiveness (network directedness, negotiating power, personal influence, verbal behaviour),
3. Operational effectiveness (result orientation, individual effectiveness, risk-taking, control),
4. Achievement Motivation (drive, professional ambition, innovativeness, stability).

Once the potential of an employee is measured along these dimensions on a five-point scale. Philips lays down a fast-track, career growth plan for the star performers. (5 year to 10 year plan). Companies like Glaxo, Cadbury have similar processes in place to separate the star performers from the employee ranks and exploit their potential fully using rewards and incentive schemes to good effect.

SUMMARY

- Performance appraised systems are designed to improve performance, they broadly cover three areas: define performance, facilitate performance and encourage performance.
- The appraisal systems are used for a variety of development and administrative purposes.
- Appraisals can be done either informally or systematically. Systematic appraisals are done annually.
- Appraisals can be done by superiors, peers, subordinates, teams, outsiders or a combination of raters. Employees also can carry out self-appraisals.

- Three types of appraisal methods are generally used: individual evaluation methods, multiple person evaluation methods and other methods, including HRA, assessment centre, and 360 degree feedback, etc.
- Appraisals should be carried out in an objective manner, scrupulously following the criteria laid down for this propose. When appraisals take a subjective route, several problems crop up instantaneously: such as rating errors, poor forms, lack of rater preparedness, ineffective organisational policies and practices.

REVIEW QUESTIONS

1. Describe in detail the process of performance appraisal.
2. Discuss the merits and demerits of critical incident technique and graphic rating scales.
3. Why does current thinking indicate that appraisal for training should be conducted separately from appraisal for promotion?
4. To what extent can appraisal problems be minimised through computerisation and by taking adequate precautions?
5. Evaluate the significance of performance appraisal in an educational institution. How would you make it more effective?
6. "Performance appraisal is not merely for appraisal but is for accomplishment and improvement of performance". Discuss.
7. Distinguish performance appraisal from potential appraisal.
8. What are the three methods of appraisal? Which method would you prefer as an employee? As a manager? Why?
9. Suppose you are a supervisor. What errors might you make when doing an employees' performance appraisal?

BBA-101

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