

# GOKUL GLOBAL UNIVERSITY

Faculty of Commerce & Management

E-Content



Course:	Bachelor's of Business Administration
Semester:	3 <sup>rd</sup>
Subject:	MARKETING MANAGEMENT
Subject Code:	FMB230101

Address: - Gokul Global University, SurjapuriPatia, Opp. I.O.C. Depot. State Highway- 41, Siddhpur-384151, Gujarat

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**Prepared By:** Dr. Ashabahen J Rabari

# Program Details

**Program:** Bachelor of Business Administration (BBA)

**Subject / Branch:** Management

**Year:** 2nd Year

**Semester:** 3rd

**Course Title:** Marketing Management

**Course Type:** Core Compulsory

**Course Code:** FMB230101

**Course Credit:** 04

**Pre-Requisite:** 10+2 (Commerce) from a recognized education board

## Rationale

This course aims to familiarize students with the key concepts, principles, and practices of Marketing Management. It focuses on understanding consumer behaviour, market segmentation, advertising, and contemporary marketing issues. The course develops analytical abilities in students to apply marketing concepts for business decision-making and strategy development across different markets and industries.

## Teaching & Examination Scheme

Teaching Scheme (Hours/Week)	Examination Scheme	Marks
Lecture: 4	Internal – Mid	20
Tutorial: 0	Internal – CE	10
Practical: 0	External Exam	70
<b>Total Credits: 4</b>	<b>Total Marks</b>	<b>100</b>

## Course Objectives

1. To outline key marketing concepts and their applications in different markets.
2. To identify factors and processes essential for designing marketing strategies.
3. To analyze and evaluate the implementation of marketing concepts and strategies in business organizations.

## Course Outcomes

On successful completion of this course, students will be able to:

1. Understand and explain the fundamental concepts of Marketing Management and their applications in different markets.
2. Identify and analyze the factors influencing marketing strategy design.
3. Evaluate the implementation and effectiveness of marketing strategies in organizations.
4. Formulate a basic marketing plan to meet business goals and customer needs.

# Course Content

## Unit – I : Buyer Behaviour

**Credit:** 1 | **Weightage:** 25%

### Topics Covered

- Consumer Markets and Industrial Markets
- Model of Consumer Behaviour
- Factors Influencing Consumer Behaviour
- Consumer Buying Decision Process
- Characteristics of Industrial Market
- Major Factors Influencing Industrial Buying Behaviour
- Types of Buying Decisions
- Process of Making Buying Decisions

## Unit – II : Target Marketing & Consumerism

**Credit:** 1 | **Weightage:** 25%

### Target Marketing

- Concept of Market Segmentation
- Bases of Market Segmentation
- Evaluation of Segments
- Target Marketing Strategies

### Consumerism

- Meaning and Concept of Consumerism
- Causes of Consumerism
- Consumer Movement in India

## Unit – III : Advertising

**Credit:** 1 | **Weightage:** 25%

### Topics Covered

- Meaning & Role of Advertising
- Objectives / Goals of Advertising
- Determination of Advertising Budget
- Simple Models of Budgeting
- Dynamic Models
- Competitive Model
- Adaptive Models

- Media Scheduling
- Media Planning
- Designing Advertising Copy & Format

## Unit – IV : Issues & Developments in Marketing

Credit: 1 | Weightage: 25%

### Topics Covered

- Social Aspects of Marketing
- Ethical Issues in Marketing
- Legal Aspects of Marketing
- Marketing of Services
- International Marketing
- Green Marketing
- Cyber / Digital Marketing
- Relationship Marketing
- Emerging Trends & Developments in Marketing

### Reference Books

1. Philip Kotler — *Marketing Management*
2. Sherlekar — *Introduction to Marketing Management*
3. Prof. S.A. Sherlekar & R. Krishnamoorthy — *Fundamentals of Marketing Management*
4. Dr. R. B. Rudani — *Basics of Marketing Management* (S. Chand & Company Ltd.)

### Suggested Readings

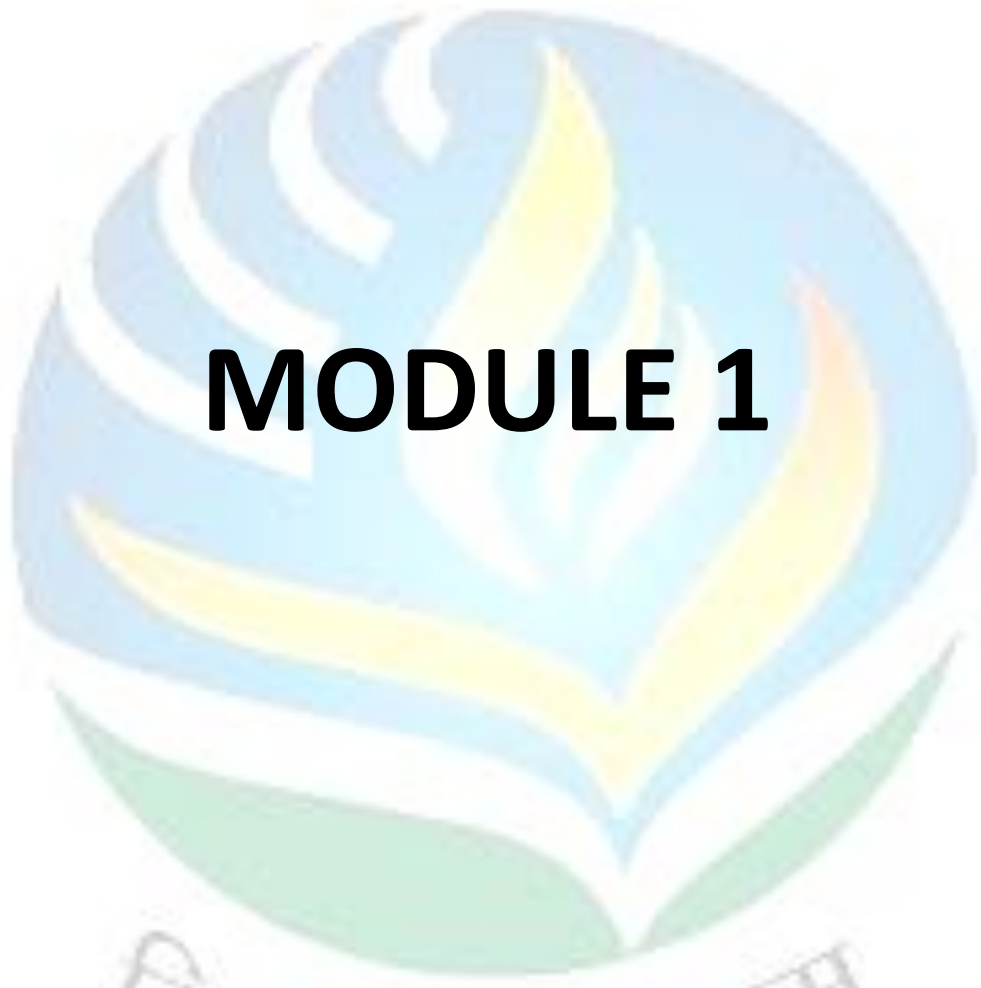
1. Prof. S.A. Sherlekar & R. Krishnamoorthy — *Fundamentals of Marketing Management*
2. Dr. R. B. Rudani — *Basics of Marketing Management* (S. Chand & Company Ltd.)

### Online Resources

- <https://www.pdfdrive.com>
- <https://www.slideshare.net>

### Practical / Activities

1. Conduct online quizzes using Google Forms or similar platforms.
2. Breakout-room activities for solving marketing case studies and practical exercises.



# MODULE 1

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## BUYER BEHAVIOR

### Meaning of Buyer Behavior

Buyer behavior refers to the study of how individuals and organizations select, buy, use, and dispose of goods and services to satisfy their needs and wants. It focuses on understanding the decision-making process of buyers, including the mental, emotional, and social factors that influence purchasing decisions. Studying buyer behavior helps marketers predict consumer responses and design suitable marketing strategies.

## CONSUMER MARKETS AND INDUSTRIAL MARKETS

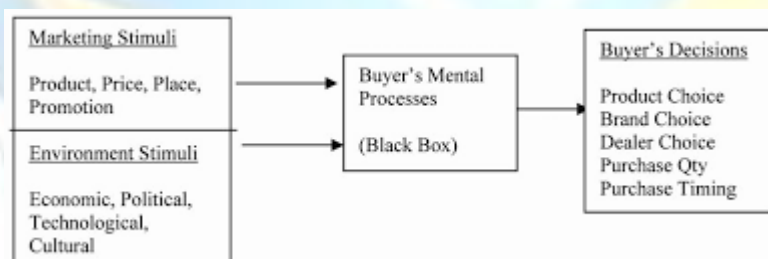
### Consumer Market

A consumer market consists of individuals or households who purchase goods and services for personal use or consumption. Products bought in consumer markets are meant to satisfy personal needs such as food, clothing, entertainment, and household items. Consumer buying decisions are usually influenced by emotions, preferences, brand image, and personal tastes.

### Industrial Market

An industrial market consists of organizations that purchase goods and services for business purposes such as production, resale, or daily operations. These buyers include manufacturers, wholesalers, retailers, government departments, and institutions. Industrial buying decisions are more rational, planned, and based on cost, quality, and long-term benefits.

## MODEL OF CONSUMER BEHAVIOR



### Marketing Stimuli

Marketing stimuli include product, price, place, and promotion offered by marketers to attract consumers. These elements influence consumers by highlighting product features, affordability, availability, and promotional messages. Effective marketing stimuli can motivate consumers to recognize needs and consider a product for purchase.

### Other Environmental Stimuli

Other stimuli include economic, technological, political, and cultural forces present in the external environment. These factors influence consumer choices indirectly. For example, economic conditions affect purchasing power, while cultural values shape preferences and buying habits.

### Buyer's Characteristics

Buyer characteristics refer to the personal traits of consumers such as cultural background, social status, personality, lifestyle, and psychological makeup. These characteristics determine how

consumers perceive products and react to marketing efforts. No two consumers behave in the same way due to differences in these characteristics.

### **Buyer's Decision Process**

The buyer's decision process represents the mental stages a consumer passes through before and after making a purchase. It includes recognizing a problem, searching for information, evaluating alternatives, making the purchase, and evaluating satisfaction after purchase.

### **FACTORS INFLUENCING CONSUMER BEHAVIOR**



#### **Cultural Factors**

Cultural factors include culture, subculture, and social class, which strongly influence consumer behavior. Culture shapes values, beliefs, and customs that guide consumption patterns. Consumers from different cultural backgrounds often display different preferences and buying habits.

#### **Social Factors**

Social factors include family, reference groups, friends, and social roles. These groups influence consumer behavior through opinions, advice, and social pressure. Family members, in particular, play a significant role in shaping purchasing decisions for household products.

#### **Personal Factors**

Personal factors include age, occupation, income, lifestyle, and personality. A consumer's needs and preferences change with age and life stage. Income level affects purchasing power, while lifestyle reflects how a person chooses to live and spend money.

#### **Psychological Factors**

Psychological factors include motivation, perception, learning, beliefs, and attitudes. Motivation drives consumers to satisfy needs, perception affects how they interpret information, and learning shapes future behavior based on past experiences. Beliefs and attitudes influence brand preference and loyalty.

# The Consumer Buying Process



## **Problem Recognition**

Problem recognition occurs when a consumer realizes a gap between their current situation and desired situation. This need may arise due to internal factors like hunger or external factors such as advertisements. It is the first step in the buying process.

## **Information Search**

Information search involves collecting data about products or services that can satisfy the recognized need. Consumers gather information from personal sources, advertisements, online platforms, and previous experiences. The extent of search depends on the importance of the purchase.

## **Evaluation of Alternatives**

Evaluation of alternatives refers to comparing different brands or products based on features, price, quality, and benefits. Consumers evaluate available options to select the one that best meets their needs and expectations.

## **Purchase Decision**

The purchase decision is the stage where the consumer chooses a specific product and completes the transaction. This decision may still be influenced by factors such as discounts, opinions of others, or availability.

### **Post-Purchase Behavior**

Post-purchase behavior refers to the consumer's feelings after using the product. Satisfaction leads to repeat purchases and brand loyalty, while dissatisfaction may result in complaints or switching to other brands.

### **CHARACTERISTICS OF INDUSTRIAL MARKET**

#### **Fewer Buyers**

Industrial markets consist of fewer buyers compared to consumer markets. However, each buyer usually purchases large quantities, making them highly important for sellers.

#### **Large Purchase Quantity**

Industrial buyers purchase goods in bulk for production or resale purposes. These large orders involve significant financial investment and require careful evaluation.

#### **Derived Demand**

Industrial demand is derived from consumer demand. If demand for consumer goods increases, the demand for raw materials and industrial products also rises.

#### **Professional Buying**

Industrial purchases are made by trained professionals who follow formal procedures. These buyers analyze technical specifications, quality standards, and cost factors before making decisions.

#### **Long-Term Relationship**

Industrial buyers and sellers often maintain long-term relationships to ensure continuity of supply, consistent quality, and mutual benefits.

### **FACTORS INFLUENCING INDUSTRIAL BUYING BEHAVIOR**



### **Environmental Factors**

Environmental factors include economic conditions, technological developments, competition, and government regulations. These factors influence organizational purchasing decisions by affecting costs, availability, and legal requirements.

### **Organizational Factors**

Organizational factors include company policies, objectives, procedures, and structure. Purchasing decisions must align with organizational goals and internal rules.

### **Interpersonal Factors**

Interpersonal factors relate to relationships among members of the buying committee. Authority, communication, persuasion, and personal influence affect final decisions.

### **Individual Factors**

Individual factors include age, education, experience, and personality of decision-makers. Personal attitudes toward risk and innovation also influence buying behavior.

## **TYPES OF INDUSTRIAL BUYING DECISIONS**

### **1. New Task Buying**

- **Definition:** Occurs when an organization purchases a product or service for the first time.
- **Characteristics:**
  - High level of uncertainty and risk.
  - Extensive information search and evaluation of alternatives.
  - Involves multiple stakeholders in the decision-making process (e.g., technical experts, finance, procurement).
  - Often requires detailed specifications, demonstrations, and trial runs.
- **Example:** A manufacturing company decides to implement an ERP (Enterprise Resource Planning) system for the first time. They evaluate multiple vendors, compare features, negotiate costs, and conduct pilot testing before finalizing.
- **Implications for suppliers:** Opportunity to build long-term relationships by offering strong technical support, training, and after-sales service.

### **2. Modified Rebuy**

- **Definition:** Happens when an organization has prior experience with a product but wants to modify specifications, change suppliers, or renegotiate terms.
- **Characteristics:**
  - Moderate decision-making effort compared to new task buying.
  - Involves some research and supplier comparison, but less extensive than a new task.
  - Triggered by dissatisfaction with current supplier, changes in product requirements, or cost considerations.

- **Example:** A hospital has been purchasing surgical gloves from one supplier but decides to switch to a supplier offering better quality or lower price. They may also request gloves with different material specifications.
- **Implications for suppliers:** Existing suppliers must maintain quality and competitive pricing to avoid losing business. New suppliers can enter by highlighting superior value or innovation.

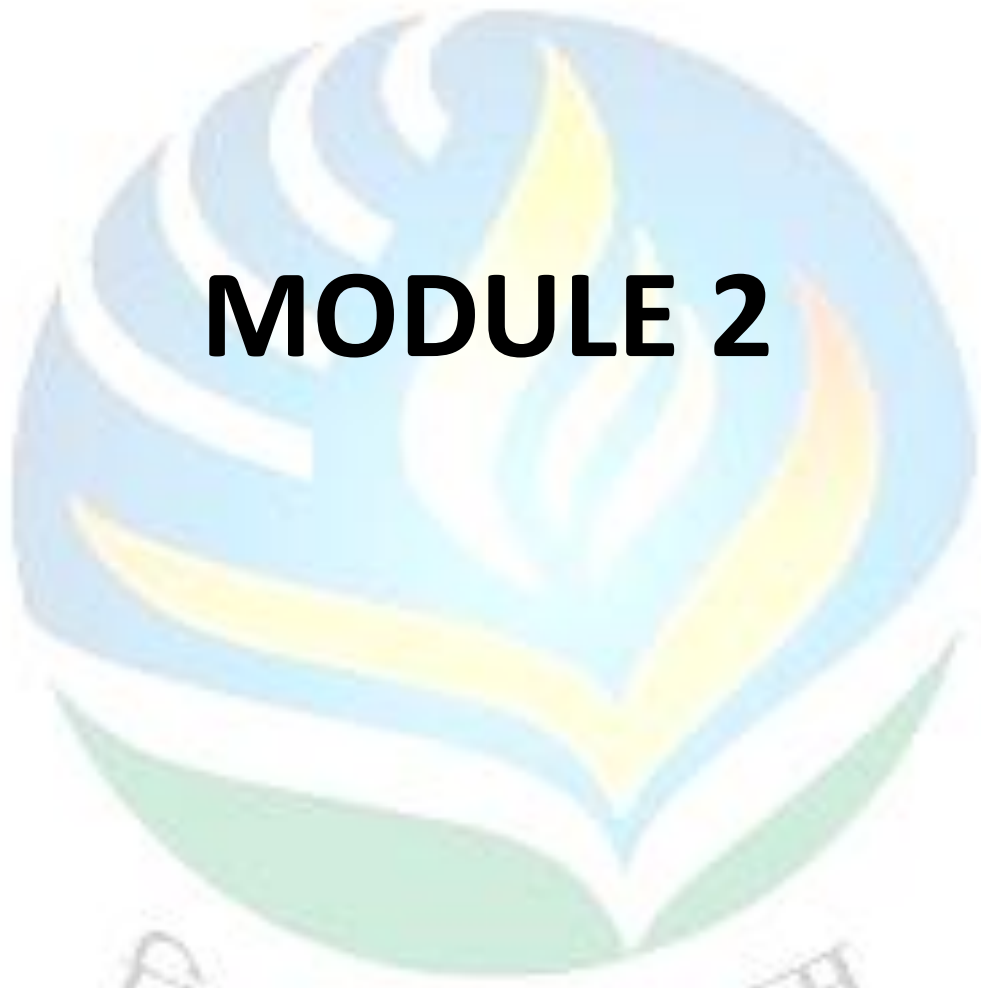
### 3. Straight Rebuy

- **Definition:** Routine purchase where the organization reorders the same product from the same supplier without modifications.
- **Characteristics:**
  - Low involvement and minimal decision-making effort.
  - Often automated through procurement systems or long-term contracts.
  - Focus is on efficiency, reliability, and consistency.
- **Example:** A printing company regularly orders the same brand of ink cartridges from its trusted supplier without evaluating alternatives.
- **Implications for suppliers:** Strong supplier loyalty and stable demand. However, competitors may find it difficult to break into this relationship unless they offer significant advantages.

#### HOW INDUSTRIAL BUYING DECISIONS ARE MADE

Industrial buying decisions follow a systematic process that begins with problem recognition and ends with performance evaluation. Organizations first identify a need, define product requirements, search for suppliers, evaluate proposals, select suppliers, place orders, and finally review supplier performance. This entire process is handled by a buying center consisting of users, influencers, buyers, deciders, and gatekeepers.

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## **MODULE 2**

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# TARGET MARKETING

## Meaning of Target Marketing

Target marketing is the process of identifying specific groups of customers within a broad market and designing marketing strategies to meet the needs of those selected groups. Instead of offering the same product to everyone, firms divide the market into segments, choose the most suitable segment, and develop products and marketing programs specifically for that group. Target marketing helps organizations use resources efficiently and achieve better customer satisfaction.

## MARKET SEGMENTATION

### Meaning of Market Segmentation

Market segmentation is the process of dividing a large and heterogeneous market into smaller, homogeneous groups of consumers who have similar needs, preferences, or characteristics. Each segment responds differently to marketing efforts, allowing companies to customize their products and promotional strategies. Proper segmentation helps marketers understand customers better and serve them more effectively.





## 4 Types of Market Segmentation

### Geographic

Target customers based on a predefined geographic boundary. Differences in interests, values, and preferences vary dramatically throughout cities, states, regions, and countries.

### Demographic

The process of dividing a market through variables such as age, gender, education level, family size, occupation, income, and more. This is one of the most widely used strategies amongst marketers.

### Psychographic

Focus on the intrinsic traits the target customer has. Psychographic traits can range from values, personalities, interests, attitudes, conscious and subconscious motivators, lifestyles, and opinions.

### Behavioral

Break down the way customers go through their decision making and buying processes. Attitudes towards the brand, the way they use it, and their knowledge base are all behavioral examples.

## BASIS OF MARKET SEGMENTATION

### Geographic Segmentation

Geographic segmentation refers to the division of the market on the basis of geographical factors such as country, region, state, city, town, climate, and population density. This form of segmentation is based on the idea that consumers living in different geographical locations have different needs, preferences, habits, and purchasing patterns. Climate plays a major role in influencing demand, as people in cold regions require woollen clothing, heaters, and hot beverages, whereas people in hot regions prefer cotton clothes, cooling appliances, and cold drinks. Cultural differences across regions also affect food habits, festivals, and lifestyle choices. Urban and rural markets show clear differences in terms of income levels, awareness, product usage, and brand preferences.

Geographic segmentation helps marketers adapt their products, pricing, and promotional strategies according to regional demand, making marketing efforts more effective and relevant.

## **Demographic Segmentation**

Demographic segmentation divides the market based on measurable population characteristics such as age, gender, income, education, occupation, family size, religion, caste, marital status, and life-cycle stage. This is one of the most widely used forms of market segmentation because demographic data is easily available and directly related to consumer needs and buying behavior. Different age groups have different preferences; for example, children demand toys and chocolates, teenagers prefer fashion and electronic gadgets, while older people focus more on healthcare products.

Income level affects purchasing power and determines whether consumers buy premium or economy products. Gender influences buying decisions in categories such as clothing, cosmetics, and personal care products. Family size and marital status affect the demand for housing, vehicles, and household goods. By using demographic segmentation, marketers can design products and marketing messages that suit the specific needs of each group.

## **Psychographic Segmentation**

Psychographic segmentation is based on the psychological characteristics of consumers such as lifestyle, personality, values, attitudes, opinions, and interests. Unlike demographic segmentation, which focuses on who the consumer is, psychographic segmentation focuses on how the consumer thinks and lives. Consumers with the same demographic profile may show very different buying behavior due to differences in lifestyle and personality. For example, two individuals with the same age and income may have different preferences if one leads a health-conscious lifestyle while the other prefers luxury and comfort.

People who value adventure may prefer travel and sports-related products, while those who value comfort may prefer home entertainment and luxury items. Psychographic segmentation helps marketers understand consumer motivation more deeply and create emotional connections through branding and promotion.

## **Behavioral Segmentation**

Behavioral segmentation divides consumers based on their behavior toward a product or brand, including usage rate, benefits sought, brand loyalty, purchasing occasions, and readiness to buy. This form of segmentation focuses on how consumers actually behave in the marketplace rather than who they are. Some consumers are heavy users of a product, purchasing frequently and in large quantities, while others are light or occasional users.

Consumers may also differ in the benefits they seek; for example, some buyers look for quality, while others focus on price or convenience. Brand loyalty plays a crucial role, as loyal customers repeatedly purchase the same brand and are less sensitive to price changes. Purchasing occasions such as festivals, weddings, or seasonal needs also influence buying

behavior. Behavioral segmentation enables marketers to design targeted offers, loyalty programs, and promotional campaigns that match consumer behavior patterns.

## **TARGET MARKETING**

### **Meaning of Target Market**

A target market is a specific group of consumers selected by a company to whom it wants to sell its products or services. After segmenting the market, companies evaluate each segment and choose one or more segments that are most profitable and suitable. The selected segment becomes the focus of all marketing activities.

## **TARGET MARKETING STRATEGIES**

### **Undifferentiated Marketing Strategy**

Undifferentiated marketing strategy is an approach in which a company targets the entire market with a single product and a uniform marketing message. Under this strategy, the firm assumes that all consumers have similar needs and preferences and therefore offers one standard product to everyone. This method focuses on mass production, mass distribution, and mass promotion in order to achieve economies of scale and reduce costs. Products such as basic food grains, salt, sugar, and essential commodities often use this strategy because demand is common across different consumer groups.

While undifferentiated marketing allows companies to minimize production and promotional expenses, it has limitations in highly competitive markets where consumer preferences differ widely. As customers increasingly seek customized products, this strategy may fail to satisfy diverse needs.

### **Differentiated Marketing Strategy**

Differentiated marketing strategy involves targeting two or more distinct market segments and developing separate products and marketing programs for each segment. In this approach, companies recognize that consumers differ in terms of needs, preferences, income levels, and lifestyles. As a result, different versions of a product are designed to appeal to different customer groups.

For example, a company may offer premium, standard, and economy versions of the same product to serve different income groups. Differentiated marketing increases market coverage, customer satisfaction, and brand loyalty because consumers feel that their specific needs are being addressed. However, this strategy also involves higher costs related to product development, advertising, and distribution, making it more suitable for large organizations with sufficient resources.

### **Concentrated Marketing Strategy**

Concentrated marketing strategy focuses on serving a single, well-defined market segment instead of the entire market. Under this strategy, a company specializes in meeting the needs of one specific group of customers more effectively than its competitors. This approach is commonly adopted by small and medium-sized enterprises that have limited resources and cannot compete in a broad market. By concentrating on a niche segment, firms can gain strong market knowledge, build customer loyalty, and establish a strong brand image within that segment. For example, a company may focus exclusively on organic food products or luxury sports cars. Although concentrated marketing offers the advantage of specialization and efficient use of resources, it also carries higher risk, as the firm's success depends heavily on the stability and growth of a single market segment.

## **Micromarketing Strategy**

Micromarketing strategy involves tailoring products, services, and marketing efforts to meet the specific needs of individual customers or small local markets. This strategy goes beyond traditional segmentation by focusing on precise customer preferences, often at a local or individual level. Micromarketing includes local marketing, where products are customized for specific regions or communities, and individual marketing, where offerings are personalized for each customer. Advances in technology, digital platforms, customer databases, and data analytics have made micromarketing increasingly popular, especially in online and e-commerce businesses. This strategy helps companies build strong customer relationships, improve satisfaction, and increase customer loyalty. However, micromarketing can be costly and complex to implement, as it requires detailed customer data and flexible production systems.

# **CONSUMERISM**

## **Meaning of Consumerism**

Consumerism refers to the organized movement of consumers to protect their rights and interests against unfair trade practices. It aims to ensure that consumers receive fair value, safe products, accurate information, and proper grievance redressal. Consumerism promotes awareness among buyers and encourages ethical behavior among businesses.

## **CONCEPT OF CONSUMERISM**

The concept of consumerism is based on the idea that consumers are entitled to certain basic rights and protections. It emphasizes that consumers should not be exploited by producers, sellers, or service providers. Consumerism seeks to create a balance between business profit motives and consumer welfare by promoting fairness, transparency, and accountability.

## **Unfair Trade Practices**

Unfair trade practices are one of the most important causes for the growth of consumerism. These practices include false and misleading advertisements, adulteration of food products,

use of substandard raw materials, overpricing, hoarding, black marketing, and deceptive sales techniques. Such unethical practices result in financial loss, health hazards, and dissatisfaction among consumers.

When consumers repeatedly face exploitation and are not provided with accurate information about products and services, they lose trust in sellers and manufacturers. As a result, consumers begin to organize themselves, demand legal protection, and seek justice through consumer forums and movements. The increasing prevalence of unfair trade practices has therefore played a major role in strengthening consumerism.

## **Growth of Mass Production**

The growth of mass production has significantly contributed to the rise of consumerism. With industrialization and technological advancement, goods are produced on a large scale and distributed through complex supply chains involving wholesalers, retailers, and agents. This system has increased the distance between producers and consumers, reducing direct interaction between them.

As a result, consumers often do not know who manufactures the product they buy, making it difficult to identify responsibility in case of defects or poor quality. This lack of direct contact limits the consumer's ability to complain or seek compensation. Consequently, the need for organized consumer protection and collective consumer action has increased, leading to the development of consumerism.

## **Increased Consumer Awareness**

Increased consumer awareness has been a major driving force behind the growth of consumerism. Rising literacy rates, better education, and widespread access to newspapers, television, social media, and the internet have made consumers more informed about products, prices, quality standards, and their legal rights.

Consumers today are more conscious of issues such as product safety, fair pricing, ethical business practices, and environmental impact. Educated and informed consumers are no longer willing to tolerate exploitation or poor service. They actively question sellers, compare alternatives, and seek redressal in case of dissatisfaction. This growing awareness has encouraged consumers to unite, demand transparency, and support consumer protection movements.

## **Complex Products and Services**

The increasing complexity of modern products and services has also contributed to the rise of consumerism. Many products today, such as electronic devices, financial services, insurance policies, and digital services, involve technical features and detailed terms and conditions that are difficult for ordinary consumers to understand. Consumers may not be able to assess the quality, safety, or long-term performance of such products at the time of purchase.

This lack of understanding increases the risk of being misled or exploited by sellers. In such situations, consumers feel the need for guidance, regulation, and protection. As a result,

consumer movements have grown to safeguard consumer interests and ensure fair practices in complex markets.

## **CONSUMER MOVEMENT IN INDIA**

### **Meaning of Consumer Movement**

The consumer movement in India refers to the organized efforts of consumers and voluntary organizations to safeguard consumer interests. It aims to protect consumers from exploitation and ensure fair business practices through awareness, advocacy, and legal action.

### **Growth of Consumer Movement in India**

The consumer movement in India gained momentum after independence due to rising cases of black marketing, hoarding, adulteration, and misleading advertisements. Voluntary consumer organizations began educating consumers and fighting for their rights.

### **Consumer Protection Act**

The enactment of consumer protection laws strengthened the consumer movement in India. These laws provide a legal framework for addressing consumer grievances and establishing consumer courts at district, state, and national levels.

### **Role of Consumer Organizations**

Consumer organizations play a key role in spreading awareness, conducting research, filing complaints, and influencing policy decisions. They act as a bridge between consumers and government authorities.

### **Importance of Consumer Movement**

The consumer movement empowers consumers, promotes ethical business practices, and improves product quality. It also ensures that consumers receive justice quickly and economically through consumer forums.

## FEATURES OF CONSUMER MOVEMENT



### **Prime Objective**

The prime objective of the consumer movement is to protect the interests and rights of consumers against exploitation. It aims to ensure that consumers receive fair value for money, safe and quality products, correct information, and proper redressal of grievances. The movement seeks to create awareness among consumers so that they can make informed decisions and demand justice when they are treated unfairly by sellers or service providers.

### **Voluntary Movement**

The consumer movement is largely a voluntary movement, meaning it is driven by the active participation of consumers and voluntary organizations rather than by profit motives. Consumer associations, non-governmental organizations, and social activists voluntarily work to educate consumers, file complaints, and fight against unfair trade practices. This voluntary nature strengthens the movement by encouraging public participation and social responsibility.

### **Democratic Movement**

The consumer movement is democratic in nature because it is based on equality, participation, and collective decision-making. Every consumer, regardless of income, education, or social status, has the right to raise complaints and seek justice. Consumer forums and organizations function in a transparent and fair manner, ensuring that all consumers have equal access to protection and redressal mechanisms.

## **Comprehensive Movement**

The consumer movement is comprehensive as it covers a wide range of issues related to consumer welfare. It deals with problems such as adulteration, misleading advertisements, defective goods, poor services, overpricing, and unfair contracts. The movement applies to both goods and services and protects consumers across different sectors like food, healthcare, education, banking, and digital services.

## **Protection of Rights**

One of the most important features of the consumer movement is the protection of consumer rights. These rights include the right to safety, right to information, right to choice, right to be heard, right to seek redressal, and right to consumer education. The movement ensures that these rights are recognized, promoted, and enforced through laws, consumer courts, and awareness programs.

## **Prevention of Malpractices**

The consumer movement aims to prevent malpractices by discouraging unethical business behavior. By exposing unfair trade practices such as hoarding, black marketing, false advertising, and adulteration, the movement creates pressure on businesses to act responsibly. Strict laws and active consumer participation help reduce exploitation and promote fair trade practices.

## **Unity Among Consumers**

Unity among consumers is a key feature of the consumer movement. When consumers unite and act collectively, their voice becomes stronger and more effective. Consumer organizations bring individuals together to fight common problems, share experiences, and support each other in legal and social actions. This unity increases the bargaining power of consumers and strengthens the movement.

## **Enforcing Consumer Rights**

The consumer movement plays an important role in enforcing consumer rights through legal and institutional mechanisms. Consumer courts and forums at district, state, and national levels provide a platform for consumers to file complaints and seek justice. These institutions ensure that violators are held accountable and consumers receive compensation or corrective action.

## **Seller Behaviour**

The consumer movement also focuses on improving seller behavior by promoting ethical and fair business practices. Awareness of consumer rights and strict enforcement of laws encourage sellers to maintain quality standards, provide accurate information, and offer fair prices. As a result, businesses become more responsible and customer-oriented, leading to healthier market practices.

## Consumer Rights



### **Right to Safety**

The right to safety ensures that consumers are protected against goods and services that are hazardous to life and health. It requires manufacturers and sellers to follow quality standards and safety regulations so that products such as food, medicines, electrical appliances, and vehicles do not cause harm to consumers.

### **Right to Choose**

The right to choose gives consumers access to a variety of goods and services at competitive prices. It protects consumers from forced selling, monopoly practices, and unfair restrictions, allowing them to select products freely according to their needs, preferences, and budget.

### **Right to Be Heard**

The right to be heard ensures that consumer interests and complaints are considered by sellers, manufacturers, and authorities. It gives consumers the power to voice grievances, provide feedback, and expect fair consideration through customer service systems and consumer forums.

**Right to Be Informed**

The right to be informed enables consumers to receive complete and accurate information about products and services. This includes details about price, quality, quantity, ingredients, usage, and risks, helping consumers make informed and responsible purchase decisions.

**Right to Healthy Environment**

The right to a healthy environment ensures that consumers live and work in surroundings that do not threaten their well-being. It emphasizes protection from environmental pollution, unsafe industrial practices, and products that harm ecological balance and public health.

**Right to Redress**

The right to redress provides consumers with the ability to seek compensation or corrective action in case of defective goods, poor services, or unfair trade practices. Consumer courts and grievance redressal mechanisms support this right by delivering justice in a simple and affordable manner.

**Right to Consumer Education**

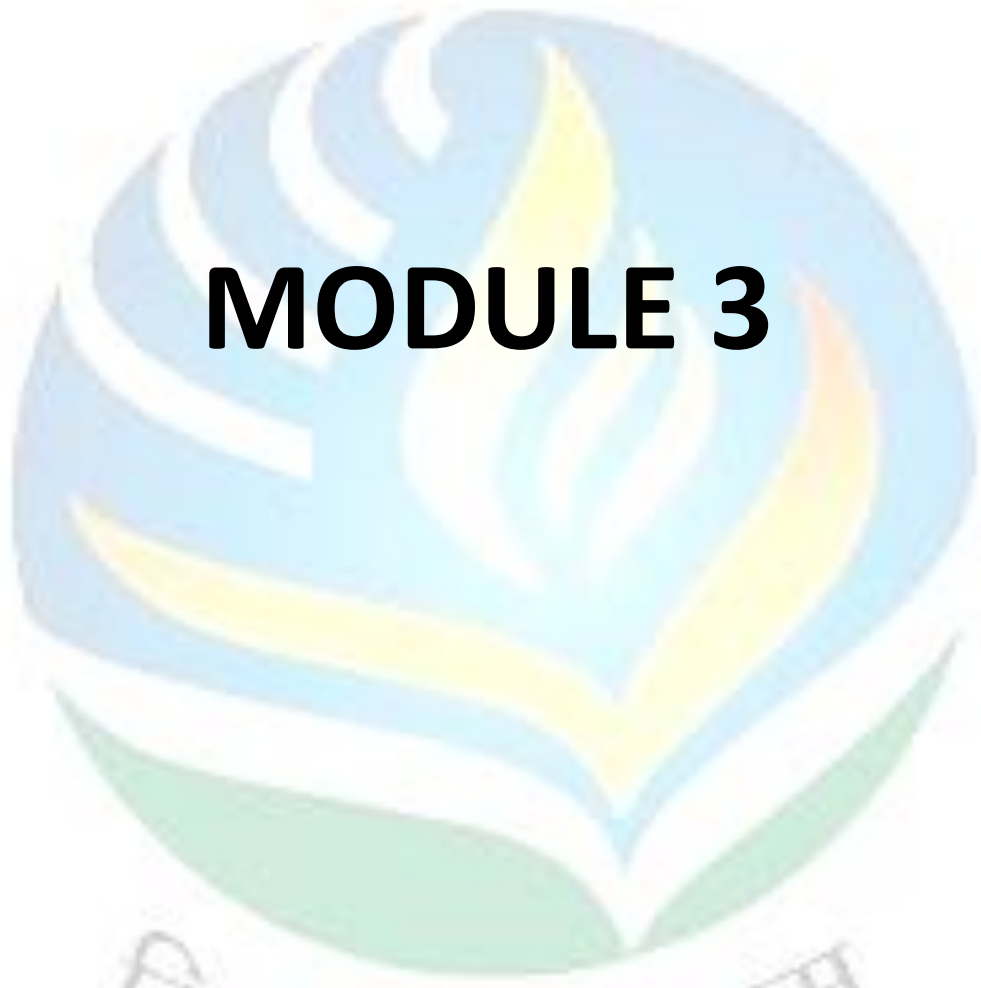
The right to consumer education ensures that consumers are informed about their rights, responsibilities, and ways to protect themselves from exploitation. Through education and awareness programs, consumers become confident and capable of making wise market decisions.

**Right to Basic Needs**

The right to basic needs guarantees access to essential goods and services such as food, clothing, shelter, healthcare, education, and sanitation. It highlights the responsibility of society and the government to ensure minimum living standards for all consumers.



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# MODULE 3

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## **Advertising**

Advertising is a form of paid, non-personal communication used by organizations to inform, persuade, and remind consumers about products, services, or ideas. It is an important promotional tool that helps businesses create awareness, build brand image, influence buying behavior, and increase sales. Advertising uses various media such as print, electronic, digital, and outdoor media to reach a wide audience effectively.

### **Goals of advertising**

Consider the following advertising goals for your company:

#### **1. Brand awareness**

Brand awareness is a measurement of how familiar consumers are with your brand. As an advertising goal, you might set numerical targets or percentages for the number of people you'd like to recognize your brand. Consider creating advertisements that incorporate your logo, brand colors and memorable images so that when making purchases, the consumer might recall your brand. This goal often combines all three advertising objectives: reminding consumers about your brand, persuading them to choose your brand and informing them about your brand.

#### **2. Traffic increase**

Traffic can mean how many people visit your website, profiles or other pages. Similar to brand awareness, you might set a goal to increase your web traffic by a specific number of visitors. Search engines and clickable images are two forms of digital advertising that can increase your traffic. If an online advertisement is interesting, consumers may click on it. Then the ad can redirect them to your website, which can increase your traffic. Similarly, companies sometimes pay to advertise within search engine results. Internet users may see these types of advertisements if they search for certain key terms.

#### **3. Engagement boost**

Engagement is how people interact with your online content and social media profiles. You can choose to target an active audience that engages frequently or a passive audience that may view your posts without engaging. To increase engagement, you can seek feedback from your audience. Then you can use that feedback to update your content and target your audience more effectively. Another way to improve audience engagement is to sponsor a giveaway. For example, a company might sponsor a giveaway that requires people to tag friends or share a social media post. This may influence passive audience members to interact more with the brand and also increase brand awareness.

#### **4. Multimedia interest increase**

Goals related to multimedia interest typically measure how interested consumers are in your content. For example, you can track how many people watch a video from beginning to end. Setting multimedia interest as a goal can help you determine:

- **The quality of content your audience is seeking:** To motivate people to watch full videos, read complete blog posts or engage fully in other online content your company produces, consider updating your content to make sure it's engaging. You can learn how to update your content effectively by conducting market research, which can help you determine what competitors do.

- **The right duration for your content:** If you're interested in improving audience engagement with your content, consider measuring how long people read your blog posts or watch your videos. Then, try creating content that's shorter or content that delivers the principal message quickly.
- **The overall interest in your content:** You can review metrics such as view count and likes to help you determine how many people are interested in your content overall.

## **5. Lead generation**

Lead generation is a method of increasing the number of potential customers who are interested in purchasing products or services from your company. Using both informative and persuasive strategies, you might advertise in new markets to generate leads and connect with new potential customers. Using search engine advertising can also be an effective way to generate new leads. For example, if a person is using a search engine to find a dog walker, they might see your company in their search results and contact you.

## **6. Targeted market research**

Targeted market research is a method of learning about your audience to discover their specific needs and desires so that you can advertise more effectively. Consider what you want to learn about your audience, how big of a sample size you want to gather and what you might do with the information you learn. For example, you might create an advertisement on your website that prompts users to complete a survey before proceeding to your content. Learning more about customers can also help you adjust your future advertising strategies.

## **7. Attention improvement**

A goal of advertising might be to create excitement around a new product or your brand. You can use bold headlines, bright colors and clear announcements to get the attention of your target audience. If excitement is your advertising goal, you might measure your success in clicks, sales or social media follows. This can help you understand how effective your advertising campaign is and determine whether to choose a similar method to gain attention for future campaigns.

## **8. Brand development**

You can set an advertising goal to develop your brand in response to your customers' feedback. Consider experimenting with narrative content, sponsored ads or traditional advertising. Then review which types of advertisements consumers responded to most and use that information to create effective advertisements in the future. Similarly, you might make subtle adjustments to the fonts on your website, your brand colors or your logo in response to customer feedback. Then you can continue to make alterations to ensure you're creating content your customers enjoy.

## **9. Customer retention**

Customer retention is a measurement of how many customers continue purchasing from your company after making their first purchase. To boost your customer retention, you might advertise new loyalty programs that reward your customers or offer new discounts monthly. You can also measure your customer churn rate, which means the pace at which customers start or stop engaging with your brand. This is a great metric for reviewing whether your customer retention efforts are effective.

## **10. Positioning and differentiation**

Positioning refers to how your customers think about your brand. For example, if you work for an organic fast-food restaurant, you may want your consumers to think of a quick, nutritious meal when they see your brand logo. To influence how your customers think about your brand, you can create advertisements that compare your products with a competitor's to highlight the value of your products. This type of ad can differentiate your brand and influence consumers to choose your products. You might measure this advertising goal by examining your sales in contrast to a competitor's sales.

### **11. Sales and profits**

One of the most common goals of advertising is to increase sales and improve profits. If making a direct sale is your advertising goal, consider showcasing your products and services online by using persuasive techniques. For example, a clothing company might advertise on websites with the direct goal of selling a particular item. In those advertisements, the company might use happy models to appeal to its target customers. You might also create promotional materials that indicate an urgent event such as a single-day sale to attract customers. You can measure your achievement of this advertising goal by calculating the amount of revenue the company earns during the advertising campaign.

#### **Determining an Advertising Budget: 5 Methods**

##### **Method # 1. The Percentage of Sales Approach:**

In this method, the sales value of the preceding year is first taken and then the expected sales during the year in question are arrived at. Thereafter, some percentage of the expected sales is considered and this is known as the percentage of sales approach.

This method was dominant in the past and even now it is widely used. It may be a fixed percentage or a percentage that varies with conditions of sales. The method is simple in calculation. In this method, a clear relationship exists between sales and advertising expenses. By adopting this method advertisement war can be avoided.

In spite of these advantages, this method has little to justify it. This method does not provide a logical basis for choosing the specific percentage except what has been done in the past or what competitors are doing. It discourages experimenting with countercyclical promotion or aggressive spending.

The aim of advertising is to increase the demand for the product and therefore it should be viewed as the cause, not the result of sales. But this approach views advertising on the results of sales. It leads to a budget set by the availability of funds rather than by market opportunities.

##### **Method # 2. The All-You-Can Afford Approach:**

Under this approach, a company spends as much on advertising as it can afford. It can spend for advertising as much as the funds permit. From the name itself, it is clear that the affordable amount set aside for advertising is known as affordable method. This approach appears to be more realistic, for all companies generally spend that much amount on advertisements which they can afford, even though they may not say so.

As advertising outlays are growing out of all proportions in the modern business, this method seems to provide a basis for many firms with regard to advertising outlet. Generally, a firm has to take into account the financial constraints while resorting to advertisement schemes.

As Joel Dean rightly says, **“The limit of what a company can afford ought to involve ultimately the availability of outside funds. In this sense firm’s resources set a real limit on advertising outlay. However, this limit may be above the limit set by marginal-return criterion.”**

This approach to spending on advertising sometimes proves uneconomical. The point upto which a firm can afford to spend is a limiting point. If the increase in sales does not match the expenditure on advertising, it is evident that this is not a wise or economical way of determining the budget.

**This approach is helpful in the following ways in determining the advertising budget:**

- (i) “It produces a fairly defensible cyclical timing of that part of advertising outlay that has cumulative long-run efforts.”
- (ii) This method is more suitable to the marginal firms.
- (iii) This method sets a reasonable limit to the expenditure to be incurred on advertising.

**However, the method has got some inherent weaknesses and they are the following:**

- (i) It is difficult to plan long-term marketing development.
- (ii) The opportunities of advertising may be overlooked.

**Method # 3. The Return on Investment Approach:**

This approach treats advertisement as a capital investment rather than as a more current expenditure.

**Advertising has a two-fold effect:**

- (i) It increases current sales.
- (ii) It builds up future goodwill.

An increase in current sales involves such decisions as the selection of the optimum rate of output in order to maximise short run profits. The building up of goodwill for the future calls for a selection of the pattern of investment which is expected to produce the best scale of production, leading to the maximum long run profits.

This method emphasizes the relation between advertisement and sales. Sales are measured with advertising and without advertising. The rate of return provides a basis for advertising budgeting, as the available funds will have to be distributed among various kinds of internal investment on the basis of prospective rate of return.

The limitation to the return on investment approach is that one cannot accurately judge the rate of return as advertising investment.

**It involves the following problems and they are:**

- (i) Problem of measuring the effect of advertisement accumulation as long run sales volume.
- (ii) Problem of estimating the evaporation of the cumulative effects of advertising, and
- (iii) Problem of distinguishing of investment advertising from outlays for immediate effect.

**Method # 4. The Objective and Task Approach:**

This method is also known as the research objective method. This method became prominent during the war time. This method calls upon marketers to develop their promotion budgets by defining their specific objectives, determining the tasks that must be performed to achieve these objectives and estimating the cost of performing these tasks. The sum of these costs in the proposed budget.

This approach is an improvement over the percentage of sales approach. But the fundamental relationship between the objectives and the advertising media again depends upon the past experience of the firm. In reality, tasks to be determined should be related to the objectives of the firm and to the past records of the firm.

**This method has the following advantages:**

- (i) It requires management to spell out its assumption about the relationship between amount spent, exposure level, trial rates and regular usage.
- (ii) This method can be extended to highly promising experimental and marginal approaches.
- (iii) With the help of this method a clear advertisement programme can be drawn.

There are inherent defects in this approach. The important problem of the method is to measure the value of such objectives and to determine whether they are worth the cost of attaining them. This method is also highly irrational.

**Method # 5. The Competitive Parity Approach:**

This approach is nothing but a variant of the percentage of sales approach. A firm sets its budget solely depending upon the basis of competitors expenditure. The advertising cost is decided on the basis of spending for advertising by the competitors in the same industry.

Two arguments are advanced for this method. One is that the competitors' expenditures represent the collective wisdom of the industry. The other is that it maintains a competitive parity which helps to prevent promotion wars.

Joel Dean claims that this method is widely used. The defensive logic of large proportion of advertising outlay aims at checking the inroads that might be made by competitors. The money which an individual firm spends does not reveal how much it can afford to spend in order to equate its marginal benefits with marginal costs. He finds that no correlation appears to exist between the outlay and the size of the firm.

Further, Dean defends this approach on the ground that the advertising percentages of competitors represent the combined wisdom of the industry. Another advantage of this method is that it safeguards against advertising wars. The main advantages of the method are simplicity and security of its use. For this a firm has to collect relevant data about competitors. If it is quite easy for the firm then it is quite easy for it to follow its competitors.

The major problem in this method is that the firm has to identify itself with others in the industry. Another problem is that it breeds complacency.

**Dynamic Models**

Dynamic models of advertising budgeting are advanced approaches that consider the long-term and cumulative effects of advertising on sales and brand image. These models assume that advertising does not produce immediate results only, but its impact continues over a period of time by influencing consumer awareness, attitude, and loyalty. Dynamic models use

past sales data, advertising expenditure patterns, and market response to estimate the most effective level of advertising spend. They are more scientific and realistic than simple models, as they recognize changes in consumer behavior and market conditions over time.

### **Competitive Model**

The competitive model of advertising budgeting is based on the advertising expenditure of competitors in the market. Under this model, a firm decides its advertising budget by matching or slightly exceeding the spending levels of major competitors. The main objective is to maintain market presence and avoid losing customers due to lower visibility. This model is especially useful in highly competitive markets where brands closely watch each other's promotional activities. However, it assumes that competitors' budgets are correct and may ignore the firm's own objectives and financial capacity.

### **Adaptive Models**

Adaptive models are flexible budgeting approaches that allow firms to adjust their advertising expenditure based on continuous feedback from the market. In this model, companies monitor consumer response, sales performance, and market changes regularly and modify their advertising plans accordingly. If advertising generates positive results, spending may be increased, and if response is poor, expenditure may be reduced. Adaptive models help firms respond quickly to changing consumer preferences and competitive conditions, making advertising efforts more effective and efficient.

### **Specification of the Media Schedule**

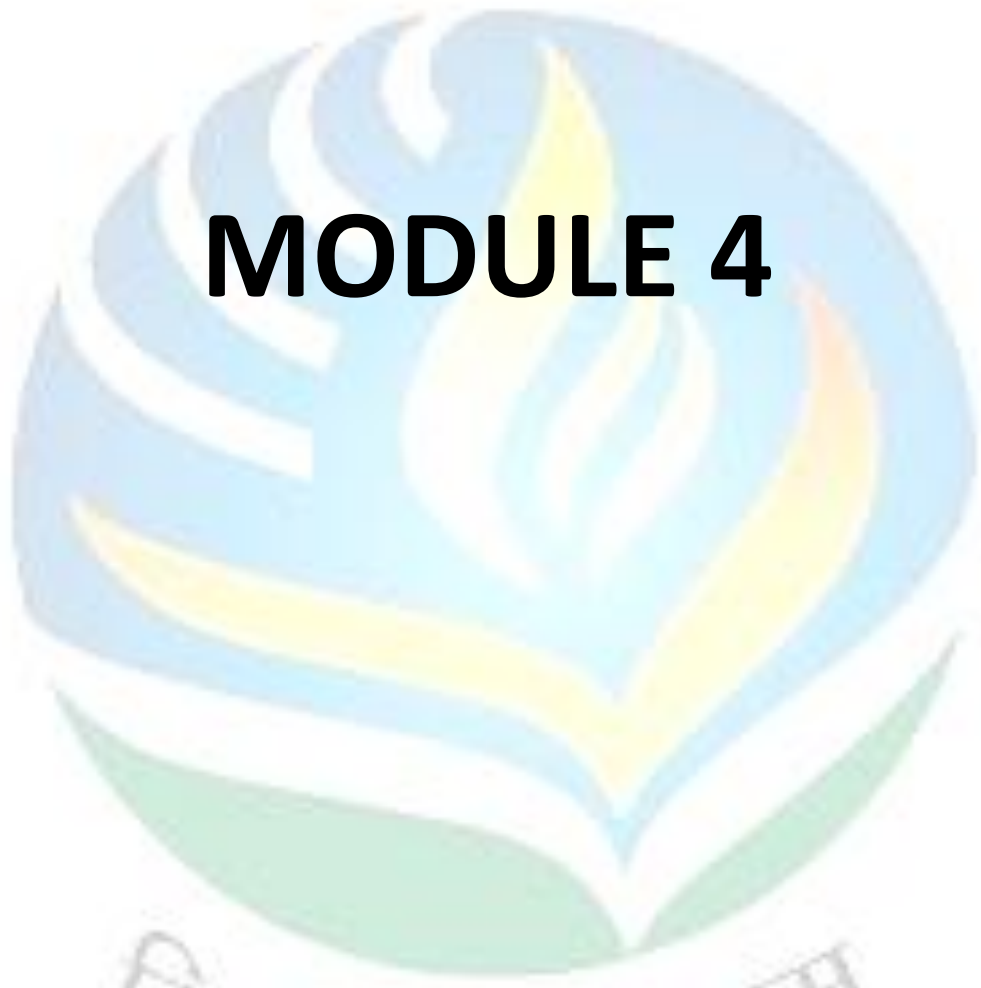
Specification of the media schedule refers to planning the timing, frequency, and duration of advertisements across selected media channels. It decides when advertisements should be released, how often they should appear, and for how long the campaign should run. A proper media schedule ensures that advertisements reach the target audience at the right time and with sufficient repetition to create impact. It also helps in controlling costs and avoiding unnecessary exposure.

### **Media Planning**

Media planning is the process of selecting the most suitable media channels to communicate advertising messages to the target audience. It involves deciding the media mix, such as newspapers, television, radio, digital platforms, or outdoor media, based on reach, frequency, cost, and audience profile. Effective media planning ensures maximum coverage of the target market with minimum wastage and plays a crucial role in the success of an advertising campaign.

### **Specification of Copy and Format**

Specification of copy and format involves designing the message content and visual presentation of an advertisement. Advertising copy includes headlines, slogans, body text, and appeals, while format refers to layout, size, color, typography, and overall design. A well-crafted copy and attractive format help capture attention, communicate the message clearly, and persuade consumers to take action. Together, they determine the effectiveness of an advertisement in influencing consumer behavior.



# MODULE 4

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## **Ethical and legal aspects Social Marketing You Should Note**

The aspects of social marketing have evolved into much more than selling goods or services, it now entails networking, building communities as well as enabling change. Social marketing takes the existing concept into greater heights. It utilizes marketing principles not to sell out a service or a commodity, but instead promotes activities that are beneficial to the person and the social network. It doesn't really matter whether you are working towards public safety, healthy living, or encouraging recycling, the features of social marketing must be understood in order to come up with impactful campaigns.

This blog highlights the fundamental characteristics of social marketing works towards social good undertakings, further explaining how each of them helps bring about a positive change through social initiatives.

### **What Is Social Marketing?**

Social marketing is the strategic application of marketing principles and techniques to further enhance the well being of a certain society. Unlike traditional marketing that sells goods or services, social marketing focuses on persuasion and changing attitudes and behavior for a more noble purpose.

To give an example, there are campaigns that motivate people not to smoke, use public transport, and even conserve water. All these activities stem from social marketing. The difference with other types of marketing is that these programs seek not to make profit, but to improve the quality of life, create awareness and proffer solutions to societal problems.

What exactly makes social marketing as effective as it is? Let's break down its key aspects.

#### **1. Behavior Change Focus**

Social marketing revolves itself around behavior change, whether it is adopting a new habit, ceasing an old one, or maintaining a good one. Unlike commercial marketing which specializes in selling a good, social marketing's "product" is a behavior.

#### **To illustrate:**

Cigarette smoking cessation programs try to lower the prevalence of actively smoking by convincing people to quit. Recycling activities help in encouraging responsible waste sorting and recycling. Public health policies may also encourage people to regularly exercise or build healthy eating habits.

Some of the major strategies include barrier removal and specific actionable persuasive messaging. The message must be strong and empower action so that the changes sought after through the behavior seem wonderful and favorable.

#### **2. Approach Based on the Audience**

Social marketing succeeds when campaigns are entirely rotated to be audience-centric. This focuses on the specific needs, values, and motivations along with the audience's barriers relative to the campaign. Campaign creators need to imagine themselves as the audience in order to create messages that work.

**To illustrate:**

For a campaign to promote carpooling with the aim of minimizing traffic jams, addressing the logistical challenges like scheduling conflicts, or providing easy access to dependable carpools need to be taken care of.

Targeting young audiences for environmental stewardship is best done through social media channels like Instagram and TikTok as they are more appealing.

The campaign must go to where the audience is. Being in touch with their

**3 Using the Marketing Mix (4 Ps)**

The social marketing uses the conventional marketing mix, otherwise known as the 4 Ps, to plan its activities:

**Product** (the behavior or practice being promoted): e.g., putting on a seatbelt, recycling.

**Price** (the cost of making the change, whether financial, social, or psychological): e.g., social pressure associated with withdrawing from smoking.

**Place** (the channels where the behavior is promoted): schools, social media, public spaces, through television advertisements.

**Promotion** (the tools used to deliver the message): advertising through posters, videos, and influencers comes up with powerful messages to deliver the required message.

If these steps are thoroughly taken into consideration, campaigns will be able to lessen resistance while expanding the acceptance of the change being promoted.

**4. Strategically Developed Around Research**

Well designed social marketing campaigns stem from careful research. The audience needs to be deeply understood alongside the context of their behaviors before any strategizing can take place.

Research can include but is not limited to: Attitudinal and barrier-specific surveys, as well as focus groups aimed towards the audience.

Understanding participants' engagement in specific actions through observational studies.

Identifying opportunities for action through pattern and trend analysis.

Observed research enables marketers to understand the concerns of the target audience and issues that are directly facing them, thus formulating relatable advertisements. For example,

if research shows constituents don't understand how to recycle some materials, they will not be actively involved in these programs.

## 5. Emotional and Rational Appeals

There is a balance of emotional and rational marketers in social marketing. Emotional appeals tap into fear, empathy, pride, and even shame in order to galvanize action, whereas sound reasoning and facts are provided through rational approach.

Balanced approaches are often the hallmark of success when it comes to campaigns:

Emotional Appeal Example: Anti-Smoking Ads have a deep emotional focus when showcasing the effects of smoking on family members.

Rational Appeal Example: Energy-saving programs emphasize not only the environmental benefits of conserving electricity, but also the decrease in utility expenses.

With both elements incorporated, the campaigns are far more impactful and spur real change.

## 6. Long-Term Goals and Sustained Sustainability

Achieving a social marketing campaign's goal is rarely associated with grappling for instant gratification of an outcome; it is a slow and steady process to achieve a sustained impact. The intention is built over time to seamlessly adopt behavior that becomes second nature.

For Example:

Recycling campaigns are designed to help people adopt recycling as a habit rather than a spur-of-the-moment action.

Initiatives aimed at improving public health guides habitual exercising permanently shifting it to a lifelong extension of a person's lifestyle.

To ensure sustained behavior is achieved, social marketing should embed long-lasting engagement strategies within the initiative, whether it is educational programs or offering incentives.

## 7. Practices that are Ethical and Transparent

As social marketing deals with sensitive conversations revolving around health, safety, and equality, ethical principles should take center stage. Avoid manipulation, misinformation, or coercive tactics in campaigns.

Instead, encourage social marketing initiatives to Be upfront about their goal and who is backing the campaign.

Respect every individual's privacy, dignity and consider them as part of the audience. Messages and decisions must utilize sound and credible information.

For instance, a public health campaign aimed at promoting vaccines should not engage in scaremongering or make ridiculous claims but should instead use researched benefits and risks.

#### 8. Building Community Participation

Social marketing excels when it builds a community. Campaigns can transform individual acts into a movement by encouraging people to come together for a specific cause.

Community engagement may be in the form of Social media campaigns motivating users to post their success stories using specific hashtags.

Publicity of events like clean-up drives and health fairs aimed at achievement of a specific purpose.

Partnerships with prominent local leaders, social media influencers and organizations.

When people are involved in a collaborative effort, they tend to adhere to the commitment, as well as galvanize others to take part.

#### Increments Towards a Greater Goal

Social marketing has the potential to integrate profound and positive changes on a universal basis. By integrating the concepts of change in behavior, knowing the audience, and using ethical means, businesses and organizations can leverage social marketing to solve urgent problems in society.

If you want to use social marketing in your community or organization, identify the social or organizational behaviors and practices that need change, as these will serve as the focal point of marketing. Through audience analysis, precise communications, and appropriately designed strategies, change can be achieved through compelling campaigns.

#### The Importance of Social, Ethical and Legal Issues in Marketing

Marketing encompasses much more than just promoting products. It also involves framing appropriate messages, so that they conform to social, ethical, and legal delineations. This blog examines the ways in which these issues impact marketing as well as the reasons why every business must adopt them to establish credibility and strong lasting relationships with customers.

#### The Importance of Social, Ethical and Legal Issues in Marketing

Brands today have to deal with the highly demanding informed customers. Today's consumers expect fairness and require full responsibility when it comes to marketing. Undertaking social and ethical considerations for the actions of the company has long term positive impacts.

#### The Social Dimension of Marketing



Advertising Standards: Marketing professionals should check that adverts do not contain any inaccurate, fraudulent, or indecent content.

Privacy Regulations: Comply with data protection policies such as GDPR and CAN-SPAM and other treaties that deal with data collection and usage of the consumer's consent internationally.

Intellectual Property: Safeguard and honor trademark, copyright, and patent laws to avert contentious litigations.

As an illustration, a number of notable incidents have emerged in the public eye in the past few years. A widely spoken incident is Volkswagen facing the 'dieselgate scandal' charge. They suffered through billions of charges and loss of brand trust stemming from accusations of "clean diesel" misleading advertising. This claim alone indicates how pervasive compliance with laws in marketing has become.

### Marketing in a Manner that is Socially, Ethically and Legally Acceptable

Motivating social connection through marketing is an ideal which is difficult to achieve without violating ethical and legal standards. Yet, companies that endeavor to observe such principles tend to enjoy more sustainable loyalty and growth. Here's how businesses can integrate these principles effectively:

1. Conduct Market Research

Understand your audience well including their ideals, interests and problems they face. Create messages that respect cultural and social standards and connect on deeper levels.

2. Educate the Marketing Team

Train them on contemporary societal and social issues, marketing ethics as well as legal compliance. Allow them to approve campaigns before roll out to avoid targeted allegations.

3. Practice Integrity

Ensure the terms, conditions, intentions and any information regarding the campaign is explicit. For instance, if a promotion captures data through an offer, specify how the consumer data will be utilized.

4. Monitor Campaigns in Real-time

Even the most sincere marketing endeavors can become disastrous without active tracking. Ensure advertising materials comply with advertising codes and culturally sensitive guidelines.

5. Partner with Purpose

Work with organizations or other initiatives that resonate with your brand's social and ethical responsibilities. Many brands have economically active charitable initiatives where portions of sales are donated or manufacture eco-friendly products.

Socially, ethically and legally responsible branding has its advantages

For brands, socially responsible, ethically and legally compliant marketing practices are no longer optional; it's critical for business. Today's customers are immensely and increasingly gravitating toward brands that lead with purpose. An Edelman study in 2022 revealed a whopping 58% of consumers are willing to purchase or advocate products and brands that do so based on their values and beliefs.

Advantages to brand reputation:

Enhanced Customer Relationships: Trust-worthy businesses retain customers indefinitely.

Positive Brand Image: Showcasing brand values makes consumers proud of the brand.

Reduced Risks: Legally compliant businesses avoid negative publicity, expensive fines, overdue legal expenses and other public relations disasters.

Commit to Better Marketing Today

Marketing has continuously evolved, paving pathways into new frontiers, while making social, ethical, and legal branding responsibilities salient for today's businesses. New startups and established, seasoned companies can reliably build trust, credibility, and scalable sustainable growth by applying these principles in competitive environments.

Start building socially responsible and impactful campaigns. Keep your customers in mind by paying attention, training your staff, and aligning your corporate policies to their values.



# **GOKUL GLOBAL UNIVERSITY**

Faculty of Commerce & Management

E-Content



<b>Course:</b>	Bachelor of Business Administration
<b>Semester:</b>	03
<b>Subject:</b>	Human Resource & Management
<b>Subject Code:</b>	FMB230102

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**Prepared By:** Mr. Shamim A Sulemani

## Bachelor of Business Administration (BBA)

**Subject / Branch:** Management

**Year:** 2nd Year

**Semester:** 3rd Semester

### Course Title: Human Resource & Management

**Course Code:** FMB230102

**Course Type:** Core Compulsory

**Course Credit:** 04

**Pre-Requisite:**

10+2 (Commerce) from a recognized education board.

### Rationale

The course is designed to familiarize students with the fundamental concepts of Human Resource Management and their practical application in business organizations. It aims to build a strong conceptual base in management principles while developing an understanding of human behavior at work. The course also highlights contemporary management issues and the strategic role of HRM in achieving organizational effectiveness.

### Teaching – Examination Scheme

Teaching (Hours / Week)	Examination Scheme	Marks
Lecture	Internal Assessment	30
4	Mid: 20	
Tutorial	CE: 10	
0	External Examination	70
Practical	Total	100
0		

### Course Objectives

1. To provide a conceptual understanding of management concepts.
2. To familiarize students with contemporary issues in management.
3. To understand and appreciate human behavior in organizations.

## Course Outcomes

After successful completion of the course, students will be able to:

1. Understand the importance of Human Resource Management in today's business environment.
2. Explain the various functions and processes of HRM.
3. Develop strategies to improve the quality and effectiveness of human resources.
4. Demonstrate knowledge of key HRM functions such as recruitment, selection, training, performance appraisal, and compensation management.

## Course Content and Unit-wise Distribution

### Unit I – Introduction to Management and Planning

**Credit: 1      Weightage: 25%**

- **Management:** Meaning and process of management
- **Planning:**
  - Meaning of planning
  - Planning process
  - Planning premises
  - Types of plans:
    - Based on breadth
    - Based on use

### Unit II – Forecasting and Decision Making

**Credit: 1      Weightage: 25%**

- **Forecasting:**
  - Meaning of forecasting
  - Techniques of forecasting:
    - Historical Analogy Method
    - Survey Method
    - Business Barometers
    - Time Series Analysis
    - Regression Analysis
  - Significance of forecasting
  - Limitations of forecasting
- **Decision Making:**
  - Meaning of decision making
  - Decision-making process
  - Techniques of decision making:
    - Decision Tree
    - PERT
    - CPM

### Unit III – Organizing (Part I)

**Credit: 1      Weightage: 25%**

**A. Introduction to Organizing**

- Meaning of organizing
- Principles of organizing

**B. Departmentation**

- Meaning of departmentation
- Bases of departmentation:
  - Function-wise
  - Product-wise
  - Territory-wise
  - Process-wise
  - Customer-wise

**C. Delegation**

- Meaning of delegation
- Elements of delegation
- Principles of effective delegation

**D. Centralization and Decentralization**

- Meaning of centralization
- Meaning of decentralization
- Factors affecting decentralization
- Degree of centralization

**Unit IV – Organizing (Part II)**

**Credit: 1      Weightage: 25%**

**A. Formal Organizations**

(Only meaning, advantages, and limitations)

- Line Organization
- Functional Organization
- Line and Staff Organization
- Committee Organization

**B. Informal Organization**

- Meaning of informal organization
- Benefits of informal organization
- Problems / limitations of informal organization

**Reference Books**

1. **L. M. Prasad**, *Principles of Management*, Sultan Chand & Sons, 6th Edition.
2. **Karminder Ghuman & K. Aswathappa**, *Management – Concept, Practice and Cases*, Tata McGraw-Hill, 1st Edition (2010).
3. **Gupta, Sharma & Bhalla**, *Principles of Business Management*, Kalyani Publications, 1st Edition.

## Suggested Readings

1. **Koontz, Weirich & Aryasri**, *Principles of Management*, Tata McGraw-Hill, New Delhi, 2004.
2. **Tripathi & Reddy**, *Principles of Management*, Tata McGraw-Hill, New Delhi, 2008.
3. **Laurie Mullins**, *Management and Organisational Behaviour*, Pearson, New Delhi, 2007.

## Online Resources

- <https://www.pdfdrive.com>
- <https://www.slideshare.net>





## **MODULE 1**

विद्या अनन्तम्

# MANAGEMENT: MEANING AND PROCESS

## Meaning of Management

Management is the systematic process of getting work done through and with people in order to achieve organizational goals efficiently and effectively. It involves coordinating human efforts and physical resources such as money, materials, and machines so that objectives are achieved with minimum waste and maximum output. Management is required in every organization, whether it is a business, educational institution, hospital, or government body. It ensures proper direction, coordination, and control of activities.

## Process of Management

The process of management consists of a set of interrelated functions that managers perform continuously to achieve organizational goals.



### Planning

Planning is the first and most important function of management. It involves deciding in advance what objectives are to be achieved and how they can be accomplished. Planning provides direction and reduces uncertainty by anticipating future events and preparing suitable actions.

### Organizing

Organizing involves arranging tasks, activities, and resources in a structured manner. It includes dividing work into specific jobs, assigning duties, and establishing authority and responsibility relationships. Organizing ensures that resources are used efficiently and work is performed smoothly.

## Influencing / Leading

Leading or influencing refers to guiding, motivating, and directing employees to work towards organizational goals. It involves leadership, communication, motivation, and supervision. Effective leadership inspires employees to give their best performance and achieve desired results.

## Controlling

Controlling is the process of ensuring that actual performance matches planned performance. It involves setting standards, measuring actual results, comparing them with standards, and taking corrective actions when deviations occur. Controlling ensures discipline, efficiency, and goal achievement.

# PLANNING: MEANING AND PROCESS

## Meaning of Planning

Planning is a rational and systematic decision-making process that bridges the gap between the present position and the desired future position of an organization. It focuses on setting goals and determining the best course of action to achieve them. Planning provides clarity, direction, and coordination by deciding in advance what is to be done, how it is to be done, when it is to be done, and who will do it.

## Planning Process

The planning process consists of a series of logical steps that help managers develop effective plans.



### **Defining Objectives**

The first step in planning is defining clear and specific objectives. Objectives state what the organization wants to achieve and serve as the foundation for all planning activities. Well-defined objectives provide direction and motivation.

### **Developing Planning Premises**

Planning premises are assumptions about future conditions that affect plans. These include internal factors such as resources and policies, and external factors such as economic trends, government regulations, and market competition. Accurate premises help in realistic planning.

### **Identifying Alternatives**

At this stage, managers identify different possible courses of action to achieve objectives. There is usually more than one way to reach a goal, and identifying alternatives provides flexibility and choice.

### **Evaluating Alternatives**

Each alternative is evaluated by analyzing its advantages, disadvantages, costs, risks, and feasibility. This helps managers understand the consequences of each option before making a decision.

### **Selecting the Best Alternative**

After evaluation, the most suitable alternative is selected based on organizational objectives and available resources. This becomes the chosen plan of action.

### **Formulating Policies and Programs**

Policies provide guidelines for decision-making, while programs outline a sequence of activities required to implement the plan. Together, they act as a blueprint for future action.

### **Budgeting**

Budgeting involves allocating financial and other resources to different activities. It ensures that plans are supported by adequate resources and helps in cost control.

### **Follow-up and Control**

The final step involves monitoring the implementation of plans and taking corrective actions when necessary. Continuous follow-up ensures that plans remain relevant and effective.

## **PLANNING PREMISES**

Planning premises are the assumptions or forecasts about future conditions on which planning is based. These assumptions may relate to economic conditions, political stability, technological changes, market demand, or competition. Some premises are based on known facts such as tax laws or company policies, while others are based on expectations like changes in consumer preferences or entry of new competitors. Proper identification of planning premises is essential because inaccurate assumptions can lead to ineffective plans.

## **TYPES OF PLANS**

## TYPES OF PLANS



### Types of Plans Based on Breadth or Level

#### Strategic Plans

Strategic plans are long-term plans formulated by top management. They define the overall direction of the organization and focus on achieving broad objectives such as growth, market expansion, or diversification. These plans usually cover several years and guide the entire organization.

#### Tactical Plans

Tactical plans are medium-term plans developed by middle management to support strategic plans. They focus on specific departments or functions such as marketing, production, or finance. Tactical plans translate broad strategies into detailed action plans.

#### Operational Plans

Operational plans are short-term plans prepared by lower-level management. They deal with day-to-day activities such as work schedules, production targets, and routine procedures. These plans ensure smooth daily operations and effective execution of higher-level plans.

### Types of Plans Based on Use

#### Single-Use Plans

Single-use plans are prepared for specific situations or unique activities. They are used only

once and discarded after the purpose is achieved. Examples include project plans, event programs, and special budgets.

### **Standing Plans**

Standing plans are used repeatedly over a long period. They include policies, procedures, and rules that provide ongoing guidance for decision-making and routine activities. Standing plans ensure consistency and uniformity in organizational operations.





## MODULE 2

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## Forecasting:

Forecasting is the systematic process of **predicting future conditions** by analyzing past and present data. While planning is about deciding what to do, forecasting is about understanding the environment in which those actions will take place. It acts as a bridge between the unknown future and the actionable present.

### Techniques of Forecasting

1. **Historical analogy method** is a forecasting technique that predicts future events by comparing them with similar situations that occurred in the past. It is especially useful when a product or situation is new and lacks its own historical data. For example, the expected sales of a newly launched smartphone can be estimated by studying the sales performance of an earlier model with similar features. This method is simple and easy to apply and is helpful for forecasting demand for new products. However, its major limitation is that past situations may not repeat in exactly the same way, and the accuracy of the forecast depends heavily on how closely the past situation matches the present one.
2. **Survey method** of forecasting involves collecting opinions and expectations from customers, experts, or sales personnel to estimate future demand. It includes techniques such as consumer surveys, expert opinions, and sales force opinions. This method is valuable when historical data is not available, as it is based on direct feedback from the market. It provides insights into customer preferences and market trends. However, survey methods are often costly and time-consuming, and the results may be affected by personal bias or inaccurate responses from participants.
3. **Business barometer method** uses economic indicators to predict future business conditions. Indicators such as national income, industrial production, employment levels, and stock market trends act like a barometer that signals changes in the economy. This method is particularly useful for long-term forecasting and helps businesses and governments in economic planning. However, it is complex to understand and interpret, and the indicators used may not always give precise or timely predictions.
4. **Time series analysis** is a quantitative forecasting method that examines past data collected over a period of time to predict future trends. It breaks data into components such as trend, seasonal variation, cyclical variation, and irregular variation. This method is scientific, systematic, and widely used in sales and production forecasting. Its main limitation is that it assumes past patterns will continue in the future, making it less suitable when sudden or unexpected changes occur in the market.
5. **Regression analysis** is a statistical technique that studies the relationship between one dependent variable and one or more independent variables, such as the relationship between sales and advertising expenditure. It is highly accurate and useful for identifying cause-and-effect relationships, making it valuable for decision-making. However, this method requires sound statistical knowledge, and the reliability of the results depends on the quality and accuracy of the data used.

## Significance of Forecasting

- 1. Helps in planning and budgeting:**

Forecasting provides a strong foundation for planning and budgeting by estimating future sales, costs, profits, and resource requirements. With the help of forecasts, management can set realistic goals and prepare effective plans for production, marketing, and finance. Budget preparation becomes more accurate as future income and expenditure are anticipated in advance, helping organizations avoid financial imbalance and resource wastage.
- 2. Reduces uncertainty:**

The future is always uncertain, especially in a dynamic business environment. Forecasting helps reduce this uncertainty by analyzing past trends and present conditions to predict future events. Although it does not eliminate risk completely, it gives management a clearer picture of what may happen, allowing them to prepare in advance and respond more confidently to future challenges.
- 3. Supports decision making:**

Forecasting acts as an important input in managerial decision making. Decisions related to pricing, expansion, investment, production levels, and marketing strategies are based on future expectations. By providing estimates of future demand and market conditions, forecasting helps managers evaluate alternatives and choose the most suitable course of action with greater confidence.
- 4. Improves coordination and control:**

Forecasting promotes better coordination among different departments such as production, marketing, finance, and human resources. When all departments work based on common forecasts, their activities remain aligned with organizational objectives. It also helps in control by setting standards for performance, against which actual results can be compared and corrective actions can be taken if deviations occur.
- 5. Helps in capacity and manpower planning:**

Forecasting is essential for determining future capacity and manpower requirements. By estimating future demand, management can decide the level of production capacity needed and plan for the recruitment, training, or reduction of workforce accordingly. This prevents problems such as overstaffing, understaffing, idle capacity, or excessive workload on employees.

## Limitations of Forecasting

- 1. Forecasts are not 100% accurate:**

Forecasting deals with future events, which are uncertain by nature. No forecasting method can guarantee complete accuracy. Even the best forecasts may differ from actual outcomes due to changes in market conditions, customer preferences, or external factors beyond the control of the organization.
- 2. Based on assumptions:**

All forecasts are based on certain assumptions about economic conditions, consumer behavior, competition, and government policies. If these assumptions prove to be incorrect, the forecasts may become unreliable. Therefore, the accuracy of forecasting depends heavily on the validity of the assumptions used.
- 3. Affected by unexpected changes:**

Forecasts can be disturbed by sudden and unforeseen changes such as technological

innovations, political instability, natural disasters, or economic crises. Such unexpected events can make forecasts irrelevant or inaccurate, limiting their usefulness in decision making.

4. **Time-consuming and costly:**

The forecasting process often requires large amounts of data, skilled personnel, and advanced analytical tools. Collecting, analyzing, and interpreting data can be time-consuming and expensive, especially for small organizations with limited resources.

5. **Cannot replace managerial judgment:**

Forecasting is only an aid to management and cannot replace human judgment. Final decisions must consider managerial experience, intuition, and practical knowledge. Overdependence on forecasts without applying managerial wisdom may lead to poor decisions, especially in uncertain and rapidly changing situations.

## Decision Making

### Meaning of Decision Making

Decision making is a systematic process through which managers choose the most appropriate course of action from several available alternatives in order to achieve organizational objectives. It involves careful thinking, analysis, and judgment to solve problems and take advantage of opportunities. Effective decision making ensures proper use of resources, reduces risks, and contributes to the overall success of an organization.

### Decision Making Process



1. **Identifying the problem:**

The first and most important step in the decision-making process is identifying the real problem. A problem exists when there is a gap between the present situation and the desired state. Managers must clearly understand what the issue is, its causes, and

its impact on organizational performance. Correct identification of the problem ensures that the decision focuses on the root cause rather than just the symptoms.

2. **Collecting information:**

After identifying the problem, relevant information is gathered from internal and external sources. This may include data related to costs, market conditions, employee performance, customer preferences, and legal requirements. Accurate and sufficient information helps managers understand the situation better and reduces the chances of making wrong decisions based on incomplete or misleading data.

3. **Developing alternatives:**

Once enough information is collected, different possible solutions or courses of action are developed. Managers brainstorm and explore various options that can solve the problem. Having multiple alternatives is important because it allows flexibility and provides choices, rather than forcing a decision based on a single option.

4. **Evaluating alternatives:**

Each alternative is carefully evaluated by comparing its advantages, disadvantages, costs, risks, and expected outcomes. Managers assess how well each option aligns with organizational goals, available resources, and constraints. This step helps in identifying the most practical and beneficial alternative.

5. **Selecting the best alternative:**

After evaluation, the best alternative is selected for implementation. The chosen option should offer maximum benefits with minimum risk and should be feasible within the organization's limitations. At this stage, managerial judgment plays a key role in finalizing the decision.

6. **Implementing the decision:**

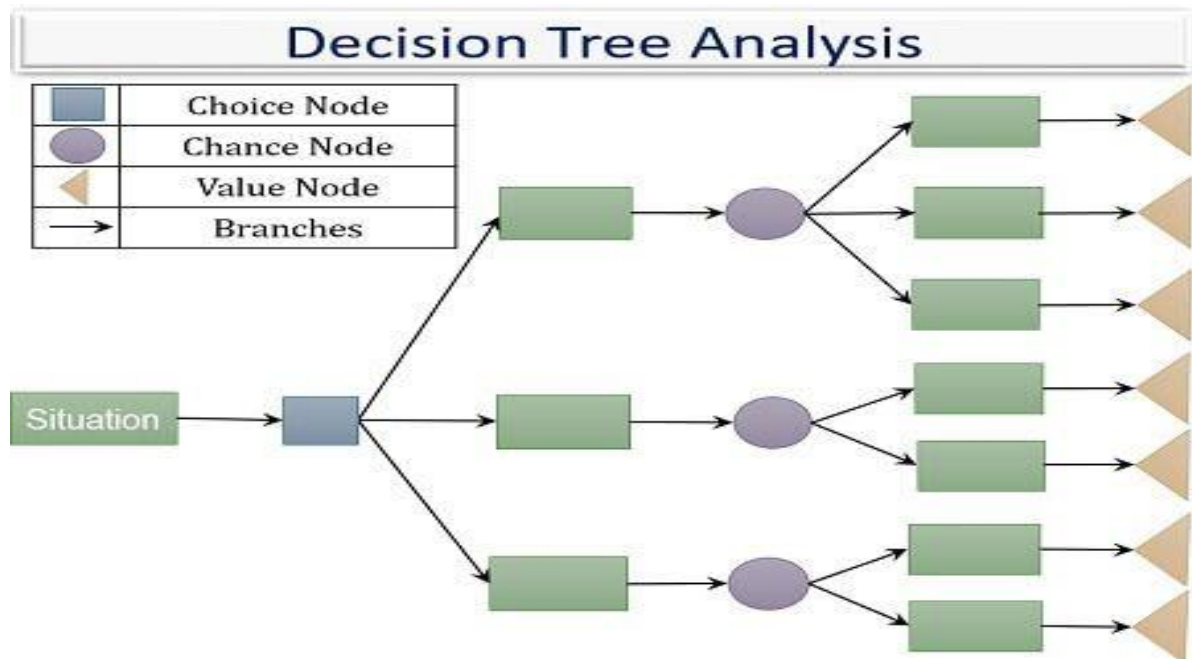
Implementation involves putting the selected decision into action. This requires proper planning, communication, allocation of resources, and cooperation from employees. Effective implementation ensures that the decision is translated into actual results. Poor execution, even of a good decision, can lead to failure.

7. **Reviewing and feedback:**

The final step is reviewing the results of the decision after implementation. Actual outcomes are compared with expected results to evaluate effectiveness. Feedback helps management identify deviations and take corrective actions if necessary. This step also provides learning for future decision making by highlighting what worked well and what did not.

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# Techniques of Decision Making



## 1. Decision Tree Technique

The **decision tree technique** is a graphical method used for decision making under conditions of risk and uncertainty. It presents various decision alternatives in the form of a tree-like diagram, where each branch represents a possible choice and its expected outcome. This method helps managers visualize the consequences of each decision step by step, making it especially useful when decisions have to be taken in a sequence over time.

### Features:

The decision tree has a clear tree-shaped structure that begins with a decision point and branches out into different alternatives and outcomes. It clearly shows the risks involved in each option by attaching probabilities to possible outcomes. This technique is particularly useful for sequential decisions where one decision leads to another depending on earlier results.

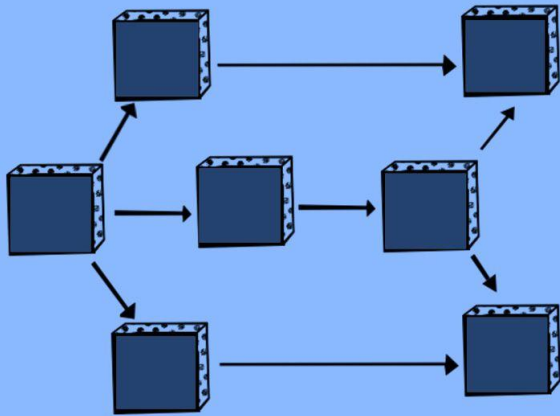
### Advantages:

One of the main advantages of the decision tree technique is that it is easy to understand and interpret, even for non-technical users. It helps in analyzing risk by showing probabilities and expected values for each alternative. Managers can compare different options visually and choose the one with the best expected result.

### Limitations:

The decision tree method can become very complex and difficult to manage when dealing with large problems involving many alternatives and outcomes. Its accuracy depends heavily on correct probability estimates, and if these probabilities are wrong or based on assumptions, the final decision may be misleading.


## 2. PERT (Program Evaluation and Review Technique)

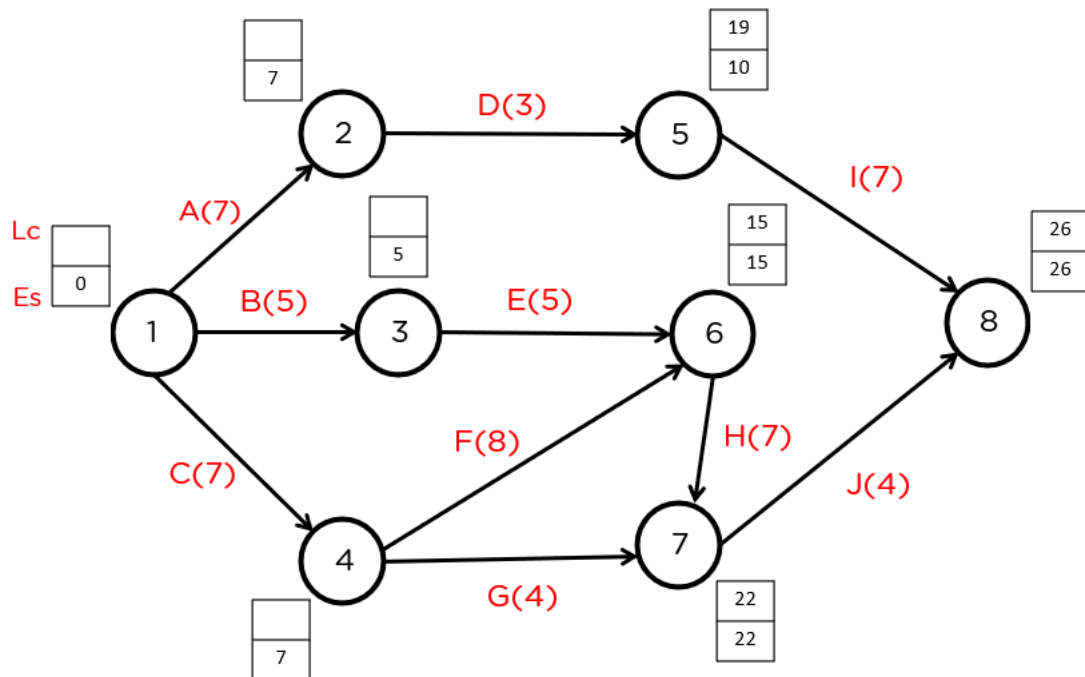


# PERT Chart

*['pərt 'tʃɑ:rt]*

A project management tool in which the stages of a project are graphically represented on a chart.





**PERT** is a project management technique used for planning, scheduling, and controlling projects where the time required for activities is uncertain. It is widely applied in research, development, and innovation-based projects where exact time estimates are difficult to predict. PERT focuses on completing projects within a specified time frame by identifying critical activities.

**Features:**

PERT is time-oriented and emphasizes the sequence and duration of activities. It uses three time estimates for each activity—optimistic time, pessimistic time, and most likely time—to calculate the expected completion time. This makes it suitable for projects with high uncertainty.

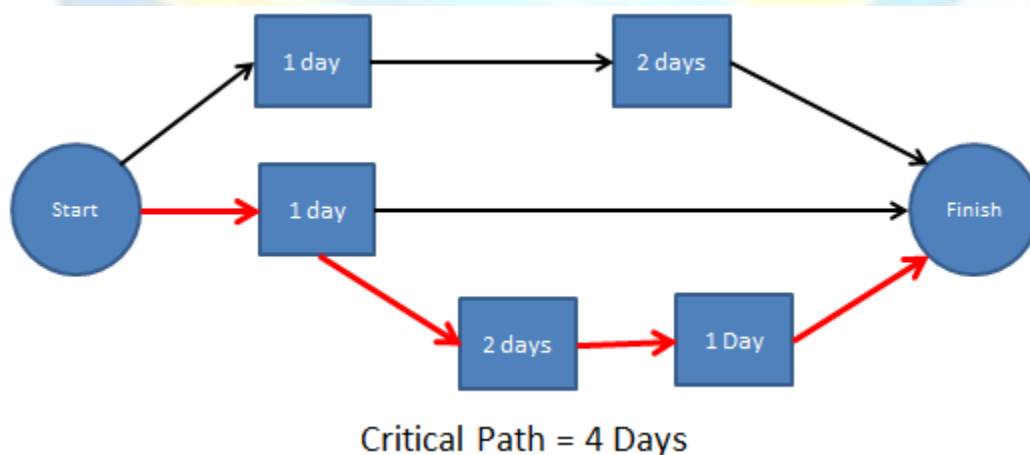
**Advantages:**

PERT helps identify critical activities that directly affect the completion time of the project. It improves time management by highlighting activities that need close monitoring. Managers can plan resources effectively and reduce delays by focusing on critical tasks.

**Limitations:**

One major limitation of PERT is that time estimates may not always be accurate, especially in highly uncertain environments. The method also involves complex calculations, which may require technical expertise and software support, making it less convenient for small projects.

**3. CPM (Critical Path Method)**



The **Critical Path Method (CPM)** is a project management technique that focuses on both time and cost control for projects where activity durations are known with certainty. It identifies the longest sequence of activities, called the critical path, which determines the minimum time required to complete the project.

**Features:**

CPM identifies the critical path, and any delay in activities on this path directly delays the entire project. It highlights critical and non-critical activities, allowing managers to prioritize tasks. This method is widely used in construction, manufacturing, and maintenance projects.

**Advantages:**

CPM improves scheduling efficiency by providing a clear project timeline. It helps in effective cost control by identifying activities where cost reduction or time compression is possible. Managers can allocate resources more efficiently and ensure timely project completion.

**Limitations:**

CPM is not suitable for projects where activity times are uncertain or unpredictable. It requires accurate and reliable data for activity durations and costs; otherwise, the results may be misleading. Additionally, preparing and updating CPM networks can be time-consuming for complex projects.





**MODULE 3**

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## Introduction to Organizing

### Meaning of Organizing

Organizing is one of the key managerial functions that focuses on arranging and coordinating the work of people and resources to achieve organizational goals effectively. It involves identifying activities required to accomplish plans, grouping similar tasks together, assigning responsibilities to individuals or departments, and establishing clear authority–responsibility relationships. Organizing comes after planning, as plans cannot be implemented unless work is properly structured, and it takes place before directing, which involves guiding and motivating employees to perform their tasks.

In simple terms, organizing determines **who will do the work, how the work will be carried out, and who will report to whom** within the organization. It creates a clear framework that defines roles, responsibilities, and communication channels. Proper organizing avoids confusion, duplication of work, and conflicts among employees. It ensures that resources such as manpower, materials, and machinery are used in the best possible way, leading to smooth functioning and improved efficiency of the organization.

### Principles of Organizing

The following principles help in building an effective organization structure:

#### 1. Principles of Organizing

The principles of organizing act as guidelines for designing a sound and efficient organizational structure. When these principles are properly followed, they help management achieve coordination, efficiency, and clarity in operations.

#### 2. Principle of Objective:

The organizational structure should always be designed with clearly defined objectives in mind. Every department, position, and activity must contribute directly or indirectly to the achievement of organizational goals. If the structure is not aligned with objectives, efforts may be wasted and performance may suffer. Clear objectives ensure that employees understand the purpose of their work and remain focused on desired outcomes.

#### 3. Principle of Specialization:

According to this principle, work should be divided and assigned based on the skills, knowledge, and abilities of employees. Specialization increases efficiency because individuals become experts in their specific tasks, leading to better quality of work and faster performance. It also reduces training time and minimizes errors, thereby improving overall productivity.

#### 4. Principle of Unity of Command:

This principle states that each employee should receive instructions from only one superior. Having multiple bosses can create confusion, conflict, and divided loyalty among employees. Unity of command ensures clarity in communication, accountability, and responsibility, making it easier for employees to understand expectations and perform their duties effectively.

#### 5. Principle of Authority and Responsibility:

Authority and responsibility should go hand in hand. When a person is given

responsibility for a task, they must also be granted sufficient authority to carry it out. Assigning responsibility without authority can lead to frustration and inefficiency, while authority without responsibility may result in misuse of power. A proper balance ensures effective performance and accountability.

6. **Principle of Span of Control:**

The span of control refers to the number of subordinates a manager can effectively supervise. A manager should oversee only a limited number of employees to ensure proper guidance, supervision, and communication. A very wide span may reduce control, while a very narrow span can increase costs and layers of management. The ideal span depends on the nature of work, employee competence, and managerial ability.

7. **Principle of Coordination:**

Coordination ensures that all departments and individuals work together harmoniously toward common organizational objectives. Since organizations consist of different units performing specialized tasks, coordination helps integrate these efforts. Effective coordination avoids duplication of work, reduces conflicts, and ensures smooth functioning of the organization.

8. **Principle of Flexibility:**

An organization structure should be flexible enough to adapt to changes in the internal and external business environment. Factors such as technological advancements, market competition, and growth may require changes in structure. A flexible structure allows management to modify roles, relationships, and processes without disrupting operations, ensuring long-term stability and success.

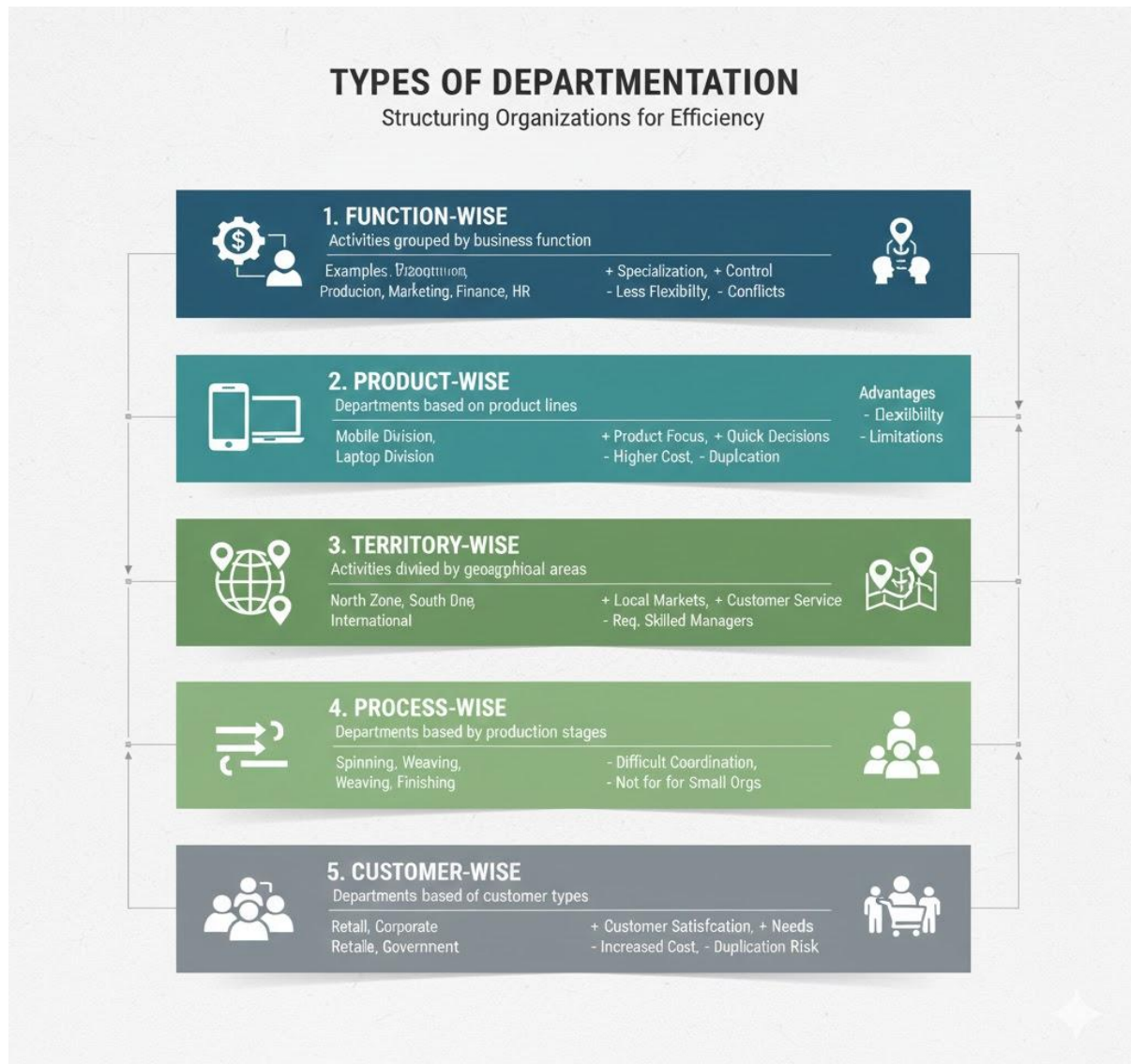
## **Departmentation**

### **Meaning of Departmentation**

Departmentation refers to the managerial process of dividing, grouping, and organizing related activities into separate units or departments within an organization. It is done to ensure that work is performed efficiently by grouping similar tasks together under a common authority. Through departmentation, large and complex organizational activities are broken down into manageable sections, making administration and supervision easier.

Departmentation facilitates specialization by allowing employees to focus on specific functions or tasks in which they have expertise. It helps in establishing clear lines of authority and responsibility, improves coordination among different departments, and ensures smooth flow of work. By creating well-defined departments such as production, marketing, finance, and human resources, organizations can achieve better control, efficiency, and effective utilization of resources.

## Types of Departmentation:



## Types of Departmentation

### 1. Function-wise Departmentation

Function-wise departmentation involves grouping activities according to the basic functions of a business. Common functional departments include production, marketing, finance, and human resources. Each department specializes in a particular function and performs tasks related to that function for the entire organization.

#### Advantages:

This type of departmentation promotes specialization and expertise, as employees focus on a single function and develop in-depth knowledge and skills. It also ensures better control and coordination within each functional area, since activities of a similar nature are handled together under one manager.

**Limitations:**

Function-wise departmentation offers limited flexibility, especially when the organization expands or introduces new products. It may also lead to departmental conflicts, as each department may focus more on its own objectives rather than overall organizational goals, reducing inter-departmental cooperation.

**2. Product-wise Departmentation**

In product-wise departmentation, departments are created on the basis of different products or product lines. Each department is responsible for the production, marketing, and profitability of a specific product, such as a mobile division or laptop division.

**Advantages:**

This structure allows better focus and attention on each product, leading to improved quality and customer satisfaction. Decision-making becomes faster because managers have authority over all activities related to their product, enabling quick responses to market changes.

**Limitations:**

Product-wise departmentation often results in higher operating costs due to duplication of resources such as staff, equipment, and facilities across departments. Maintaining separate departments for each product may not be economical, especially for small organizations.

**3. Territory-wise Departmentation**

Territory-wise departmentation divides activities based on geographical areas or regions, such as north zone, south zone, or international markets. Each region operates as a separate department to serve customers within its area.

**Advantages:**

This type of departmentation helps in better understanding local market conditions, customer preferences, and regional regulations. It improves customer service by allowing quicker response and personalized attention to regional needs.

**Limitations:**

Coordination between different territorial departments can be difficult, especially when operations are spread across wide geographical areas. It also requires skilled and experienced regional managers, which may increase administrative costs.

**4. Process-wise Departmentation**

Process-wise departmentation is based on different stages or processes involved in production. Each department handles a specific process, such as spinning, weaving, or finishing in a textile industry.

**Advantages:**

This type of departmentation increases efficiency in production by ensuring that each process is handled by specialists. It allows better utilization of machinery and equipment and improves the flow of work from one process to another.

**Limitations:**

There is a high level of interdependence between processes, so a delay or failure in one process can disrupt the entire production cycle. Process-wise departmentation is generally not suitable for small organizations due to high costs and complex coordination.

**5. Customer-wise Departmentation**

Customer-wise departmentation involves creating departments based on different types of customers, such as retail customers, corporate clients, or government agencies. Each department focuses on serving the specific needs of its customer group.

**Advantages:**

This structure improves customer satisfaction by offering specialized services tailored to the needs of different customer groups. It helps the organization understand customer behavior better and build strong relationships.

**Limitations:**

Customer-wise departmentation increases administrative costs because separate departments may require similar resources. There is also a risk of duplication of activities and facilities, which can reduce cost efficiency if not properly managed.

**Delegation**

**Meaning of Delegation**

Delegation is a managerial process through which a manager transfers a part of his or her work to subordinates by assigning duties, granting necessary authority, and fixing responsibility for the performance of tasks. It enables managers to get work done through others while retaining overall responsibility. Delegation does not mean giving up responsibility; instead, it helps managers reduce their workload, focus on important managerial activities, and develop the skills and confidence of subordinates. Effective delegation improves efficiency, motivation, and smooth functioning of the organization.

**Elements of Delegation**



1. **Authority**

Authority refers to the right given to a subordinate to take decisions, issue instructions, and use organizational resources to accomplish assigned tasks. Without adequate authority, subordinates cannot perform their duties effectively. Authority must be clearly defined so that subordinates understand the limits within which they can act and make decisions.

2. **Responsibility**

Responsibility is the obligation of a subordinate to perform the tasks assigned by the manager. It arises from the assignment of duties and cannot be delegated further. Once a task is assigned, the subordinate becomes responsible for completing it efficiently and on time. Responsibility ensures commitment and seriousness toward the assigned work.

3. **Accountability**

Accountability means being answerable for the results of the work performed. While authority can be delegated, accountability always remains with the manager. Subordinates are accountable to their superiors for their performance, and managers are ultimately accountable to top management. Accountability ensures discipline and encourages employees to achieve desired results.

## **Principles of Effective Delegation**

1. **Clarity of Duties**

For delegation to be effective, duties and responsibilities must be clearly defined. Subordinates should know exactly what is expected of them, the scope of their work, and the standards of performance. Clear instructions help avoid confusion, duplication of work, and misunderstandings.

2. **Parity of Authority and Responsibility**

Authority and responsibility should be equal in degree. A subordinate assigned responsibility must be given sufficient authority to perform the task. If responsibility is given without authority, the subordinate cannot perform effectively. Similarly, authority without responsibility may lead to misuse of power. Proper balance ensures efficiency and accountability.

3. **Unity of Command**

According to this principle, a subordinate should receive instructions from only one superior. This avoids confusion, conflicting orders, and divided loyalty. Unity of command ensures clear reporting relationships and smooth communication within the organization.

4. **Principle of Exception**

Routine and repetitive tasks should be delegated to subordinates, while managers should handle only important and exceptional matters. This allows managers to focus on strategic planning, policy-making, and critical decision making. Delegating routine work increases efficiency and speeds up operations.

5. **Adequate Training**

Delegation can be successful only when subordinates are properly trained and capable of handling assigned responsibilities. Training improves skills, confidence, and decision-making ability. Well-trained employees require less supervision and perform tasks more effectively.

6. **Proper Control System**

Even after delegation, managers must establish an effective control system. Regular feedback, reporting, and supervision are necessary to ensure that delegated tasks are

performed as expected. Proper control helps in identifying deviations early and taking corrective actions without interfering unnecessarily in the work of subordinates.

## **Centralization and Decentralization**

### **Meaning of Centralization**

Centralization refers to the systematic concentration of decision-making authority at the top level of management in an organization. In a centralized structure, important decisions related to policies, planning, finance, and operations are taken by top executives or the head office. Lower-level managers and employees mainly follow instructions and have limited authority to make independent decisions.

Centralization ensures uniformity in policies and procedures and allows top management to maintain strict control over organizational activities. For example, when all major decisions such as pricing, investment, recruitment, and expansion are taken by the head office, the organization is said to be centralized. This system is suitable for small organizations or where consistency and tight control are essential.

### **Meaning of Decentralization**

Decentralization refers to the systematic and planned delegation and dispersal of authority to lower levels of management. In a decentralized organization, decision-making power is shared with middle-level and lower-level managers, allowing them to take decisions related to their areas of responsibility. It does not mean complete transfer of authority but involves distributing authority while retaining overall control at the top.

Decentralization encourages initiative, faster decision making, and better managerial development. For example, when branch managers are empowered to take operational decisions such as staffing, local marketing, and customer service, the organization follows decentralization. This approach is suitable for large and growing organizations where flexibility and responsiveness are important.

### **Factors Affecting Decentralization**

#### **1. Cost and Importance of Decisions**

The nature, cost, and importance of decisions play a major role in determining the extent of decentralization. Decisions that involve high financial risk, long-term impact, or strategic importance are usually centralized at the top level of management to ensure uniformity and control. On the other hand, routine and low-cost operational decisions are often delegated to lower levels for quicker action.

#### **2. Management Philosophy**

The attitude and belief of top management toward employees greatly influence decentralization. If top executives believe in employee capability, initiative, and participation, they are more likely to decentralize authority. Managers who prefer tight control and are risk-averse generally favor centralization, whereas progressive management encourages decentralization to develop future leaders.

#### **3. Environmental Factors**

The nature of the business environment affects the level of decentralization. In a dynamic and rapidly changing environment, decentralization becomes necessary to

respond quickly to market changes, customer needs, and technological developments. In contrast, stable environments allow centralized decision making without major risks.

4. **Availability of Skilled Managers**

Decentralization is effective only when competent and experienced managers are available at lower levels. Skilled managers can take responsibility, make sound decisions, and handle authority effectively. If the organization lacks trained personnel, top management may hesitate to decentralize decision-making powers.

5. **Control Techniques**

The presence of effective control techniques encourages decentralization. When organizations have strong performance measurement systems, reporting mechanisms, and feedback controls, top management can confidently delegate authority. Proper control ensures that decentralized decisions remain aligned with organizational goals.

6. **Size and Growth of Organization**

The size and growth stage of an organization strongly influence decentralization. Large and expanding organizations prefer decentralization to reduce managerial burden, speed up decision making, and improve operational efficiency. Centralized control becomes difficult as organizations grow in size and geographical spread.

7. **External Environment**

External factors such as government policies, legal regulations, market competition, and economic conditions also affect decentralization. Strict government controls may limit the freedom to decentralize certain decisions, while intense competition often forces organizations to decentralize authority to respond quickly to market demands and customer expectations.





## MODULE 4

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# Types of Organizations

## Formal Organizations

### Meaning of Formal Organization

A formal organization is a consciously and deliberately designed structure created by management to achieve specific organizational objectives. It clearly defines roles, duties, authority, responsibility, and the relationships among various positions within the organization. In a formal organization, work is systematically divided, grouped, and coordinated according to established plans and policies. Every position has a clearly stated role, and employees are expected to perform their duties within the framework of prescribed rules and procedures.

Formal organizations are characterized by a well-defined hierarchy of authority, where each employee knows whom to report to and who reports to them. Communication follows official channels, ensuring discipline, order, and uniformity in operations. Rules, regulations, and standard operating procedures guide employee behavior and decision making, helping to maintain consistency and control across the organization. Examples of formal organizations include companies, government departments, schools, colleges, and hospitals, where structure and authority are officially established.

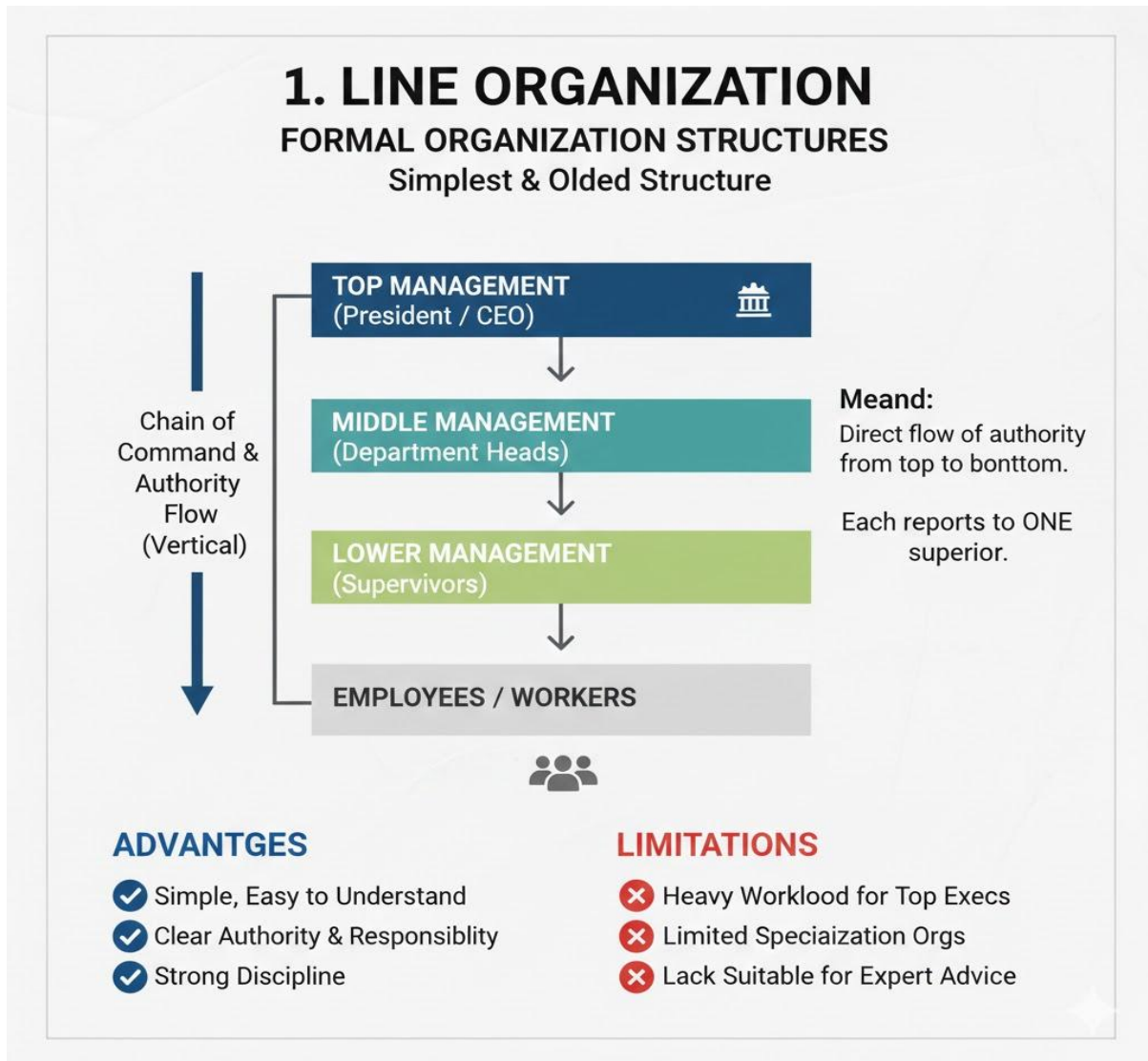
The main purpose of a formal organization is to ensure efficient coordination of activities and optimal use of resources to achieve organizational goals. While it provides stability, clarity, and accountability, it may sometimes limit flexibility and informal interaction among employees. Nevertheless, a formal organization is essential for systematic functioning, effective management control, and achievement of long-term objectives.



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## Formal Organization Structures

### 1. Line Organization



#### Meaning:

Line organization is the simplest and oldest form of organizational structure in which authority flows vertically from top management to lower levels in a direct chain. Each employee is accountable to only one immediate superior, ensuring a clear line of command and responsibility. Decisions, instructions, and communication move in a straight line from top to bottom.

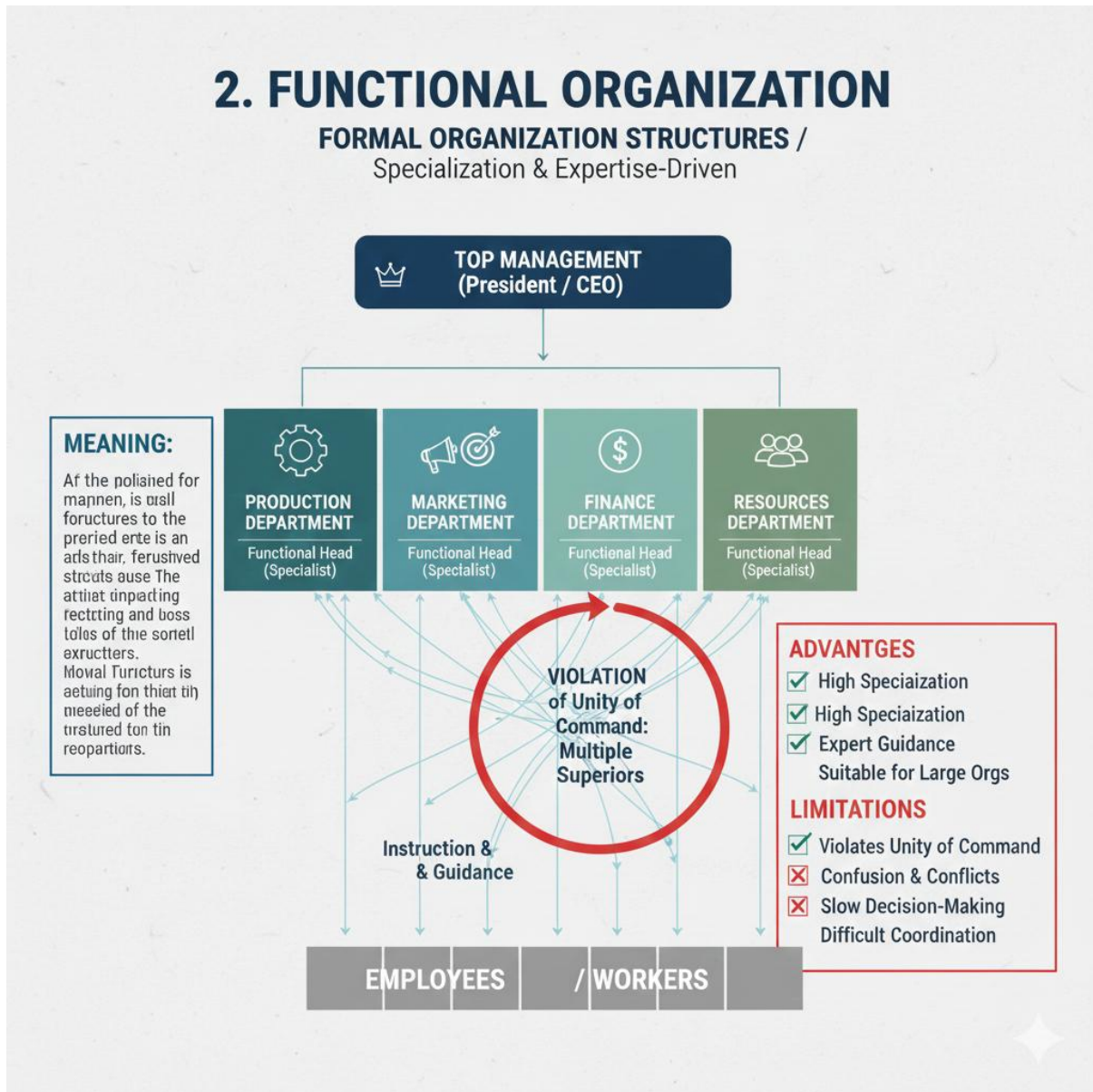
#### Advantages:

Line organization is simple to design and easy to understand, making it suitable for small organizations. Authority and responsibility are clearly defined, which avoids confusion and overlapping duties. Decision-making is quick because fewer people are involved, and strong discipline is maintained due to direct supervision and control.

**Limitations:**

Top executives bear a heavy workload as they are responsible for most decisions. There is limited scope for specialization since managers must handle multiple functions. This structure is not suitable for large organizations where operations are complex. The absence of expert advice may also reduce the quality of decisions.

**2. Functional Organization'**



**Meaning:**

Functional organization divides work according to specialized functions such as production, marketing, finance, and human resources. Employees receive instructions from functional experts rather than a single superior. Each function is headed by a specialist who guides employees in that area.

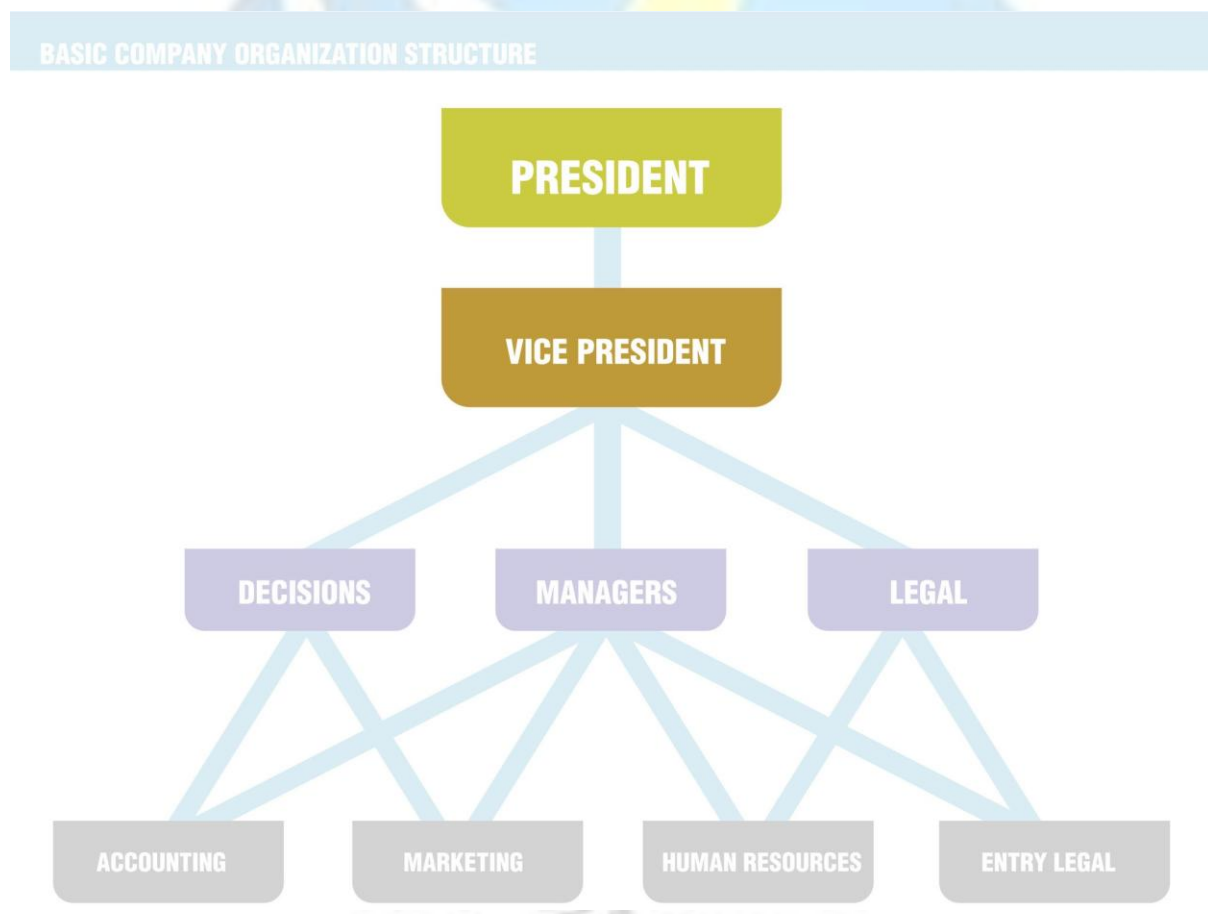
**Advantages:**

This structure promotes a high degree of specialization, leading to better efficiency and expert handling of tasks. Employees benefit from professional guidance, which improves quality and productivity. It is suitable for large organizations where complex activities require expert knowledge. The workload of top management is reduced as functional heads handle operational decisions.

**Limitations:**

Functional organization violates the principle of unity of command, as employees may receive instructions from multiple supervisors. This can create confusion and conflict. Decision-making may be slower due to consultations among functional experts, and coordination between departments can become difficult.

3. Line and Staff Organization



**Meaning:**

Line and staff organization combines the advantages of line authority with staff specialization. Line managers have the authority to make decisions and are responsible for achieving organizational goals, while staff specialists provide advice, expertise, and support without having command authority.

**Advantages:**

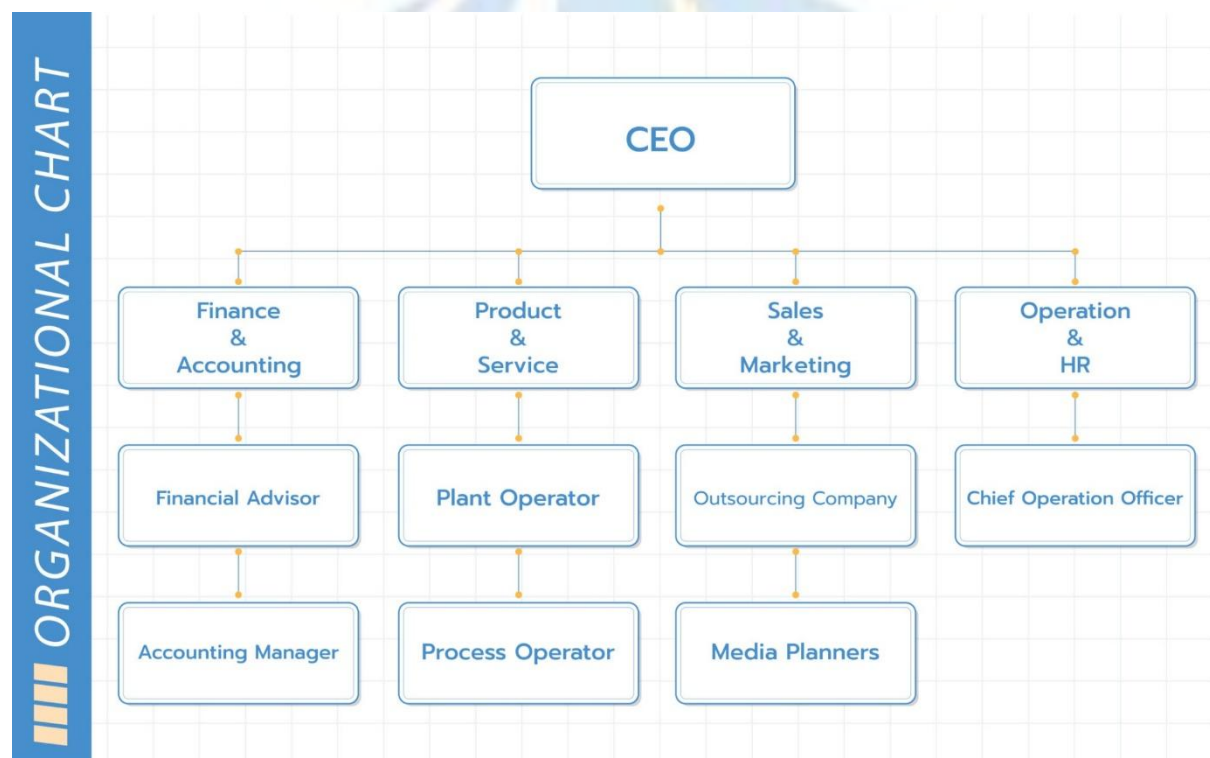
This structure offers the benefits of specialization and expert advice, leading to better quality decisions. Line managers receive relief from technical and advisory work, allowing them to

focus on core responsibilities. It is suitable for large and complex organizations where professional guidance is essential.

**Limitations:**

Conflicts may arise between line managers and staff specialists due to differences in authority and opinion. Operational costs may increase because of additional staff positions. There can be confusion regarding authority relationships, and sometimes staff advice may be ignored by line managers.

**4. Committee Organization**



**Meaning:**

Committee organization involves decision-making by a group of individuals who come together to discuss, analyze, and solve problems. Committees may be formed for planning, coordination, policy formulation, or problem-solving purposes.

**Advantages:**

Committees benefit from collective wisdom, experience, and diverse viewpoints, leading to well-thought-out decisions. They improve coordination among departments and encourage employee participation. This structure is useful for complex and strategic decisions that require careful consideration.

**Limitations:**

Committee decisions are often time-consuming due to discussions and meetings. Responsibility and accountability may be unclear, as decisions are taken collectively. Conflicts among members may arise, and decision-making may be delayed due to lack of consensus.

## **Informal Organization**

### **Meaning of Informal Organization:**

An informal organization refers to the network of personal relationships and social interactions that develop naturally among employees in the workplace. It is not created by management and does not follow official rules, authority, or hierarchy. Informal groups emerge due to friendship, common interests, shared experiences, or mutual support.

### **Benefits of Informal Organization:**

#### **1. Improves Communication**

Informal organization improves communication by allowing information to flow quickly through unofficial channels such as personal interactions, friendships, and social groups. Employees often share ideas, updates, and concerns more freely in an informal setting than through formal communication lines. This rapid exchange of information helps employees stay informed and reduces delays caused by rigid formal procedures.

#### **2. Boosts Employee Morale**

Social interaction within informal groups creates a sense of belonging and friendship among employees. When employees feel accepted and valued as part of a group, their morale and job satisfaction increase. High morale leads to better motivation, commitment, and positive attitudes toward work and the organization.

#### **3. Provides Emotional Support**

Informal organization offers emotional and psychological support to employees, especially during times of stress, pressure, or personal difficulties. Colleagues often help each other by sharing advice, encouragement, and understanding. This support reduces work-related stress and helps employees maintain emotional balance, leading to better performance.

#### **4. Encourages Cooperation**

Informal relationships promote teamwork and cooperation among employees. Strong social bonds create trust and mutual respect, which encourage individuals to help one another willingly. This team spirit improves coordination, reduces conflicts, and increases overall productivity within the organization.

#### **5. Supports Formal Organization**

Informal organization complements the formal structure by acting as a feedback system for management. Through informal interactions, managers can understand employee feelings, attitudes, and concerns more clearly. This helps management address issues early, improve working conditions, and implement policies more effectively, thereby strengthening the formal organization.

## **Limitations of Informal Organization**

#### **1. Spread of Rumors**

One of the major drawbacks of informal organization is the rapid spread of rumors and misinformation. Since informal communication does not follow official channels, information may get distorted as it passes from one person to another. False or incomplete information can create confusion, misunderstandings, fear, and

unnecessary tension among employees, which may negatively affect morale and productivity.

2. **Resistance to Change**

Informal groups often develop strong loyalties and shared beliefs among members. When management introduces new policies, technologies, or methods of working, these groups may resist change to protect their comfort zone or group interests. Such resistance can slow down implementation of decisions and reduce the effectiveness of organizational reforms.

3. **Lack of Accountability**

In an informal organization, there are no clearly defined roles, authority, or responsibility. As a result, it becomes difficult to fix accountability when mistakes occur or goals are not achieved. The absence of formal responsibility can lead to carelessness, lack of discipline, and reduced efficiency in work performance.

4. **Conflict with Formal Rules**

Informal norms and practices may sometimes conflict with the official rules and policies of the organization. Employees may give more importance to group expectations than to formal instructions. This can weaken management authority, reduce compliance with organizational policies, and create disciplinary problems.

5. **Negative Group Pressure**

Informal groups may exert pressure on members to conform to group behavior, even if it is not in the best interest of the organization. High-performing employees may be discouraged from working harder or showing initiative if it goes against group norms. Such negative group pressure can reduce motivation, innovation, and overall organizational performance.



# **GOKUL GLOBAL UNIVERSITY**

Faculty of Commerce & Management

E-Content



<b>Course:</b>	Bachelor of Business Administration
<b>Semester:</b>	03
<b>Subject:</b>	Taxation - 1
<b>Subject Code:</b>	FMB230103

**Address:** -Gokul Global University, SujanpurPatia, Opp. I.O.C. Depot. State Highway- 41, Siddhpur-384151, Gujarat

**Prepared by:** Dr. Ashabahen J Rabari

# Program Details

**University:** Gokul Global University

**Mode:** Open & Distance Learning (ODL)

**Program:** Bachelor of Business Administration (BBA)

**Semester:** 3rd Semester

**Subject Name:** Taxation – I

**Subject Code:** FMB230103

**Course Type:** Core Compulsory

**Credits:** 04

## Course Rationale

Taxation–I is designed to introduce students to the fundamentals of the Indian taxation system. The course helps learners understand basic concepts of income tax law, residential status, scope of total income, exempted incomes, and heads of income. It provides a strong foundation for tax computation and compliance, which is essential for managerial decision-making and business operations.

## Course Objectives

The objectives of this course are to enable students to understand the structure of the Indian Income Tax system, explain basic concepts and definitions under income tax law, determine residential status and tax liability, identify exempted incomes, and classify income under various heads for tax purposes.

## Course Outcomes

After successful completion of the course, students will be able to understand the framework of income tax law in India, determine the residential status of different persons, identify taxable and exempted incomes, classify income under various heads, and apply basic provisions of income tax for computing total income.

## Course Content (Unit-wise Description)

### Unit I – Introduction to Income Tax and Important Definitions

Meaning of tax and income tax, the historical background of income tax in India, and the constitutional authority of the Central Government to levy income tax. the components of income tax law such as the Income Tax Act, Income Tax Rules, Finance Act, circulars, and judicial decisions. the basis of charge of income tax under Section 4 and important definitions such as assessment year, previous year, person, assessee, income, gross total income, and total income.

### Unit II – Residential Status and Incidence of Tax Liability

Concept of residential status and its importance in determining tax liability. explains the meaning of resident and non-resident, resident and ordinarily resident, and resident but not ordinarily resident. the conditions for determining residential status of individuals, Hindu Undivided Families, firms, companies, and other persons. the scope of total income based on residential status and discusses income received, income deemed to be received, income accruing or arising in India, and income deemed to accrue or arise in India.

## **Unit III – Exempted Incomes**

Incomes exempt from tax under the Income Tax Act, including agricultural income, share of profit from a firm, specified interest incomes, leave travel concession, gratuity, pension, leave encashment, provident fund receipts, and other exemptions under Section 10..

## **Unit IV – Heads of Income (Conceptual Introduction)**

five heads of income under the Income Tax Act—salary, house property income, business or professional income, capital gains, and income from other sources.

## **Teaching and Examination Scheme**

### **Teaching Method:**

Self-learning material, online lectures, recorded video sessions, and interactive discussion forums.

### **Evaluation Pattern:**

Internal Assessment – 30 Marks  
External Examination – 70 Marks  
Total – 100 Marks

## **Reference Books**

1. Singhania, V. K. – *Direct Taxes: Law and Practice*, Taxmann Publications
2. Mehrotra, H. C. – *Income Tax Law and Accounts*, SahityaBhawan

## **Suggested Readings**

1. Girish Ahuja & Ravi Gupta – *Systematic Approach to Income Tax*
2. B. B. Lal – *Income Tax Law and Practice*

## **Online Learning Resources**

- [www.incometaxindia.gov.in](http://www.incometaxindia.gov.in)
- [www.taxmann.com](http://www.taxmann.com)
- [www.pdfdrive.com](http://www.pdfdrive.com)
- [www.slideshare.net](http://www.slideshare.net)



## Module 1

विद्या अनन्तम्

## Unit-1

### Brief history in income tax in India

In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. Thereafter, several amendments were made in it from time to time. In 1886, a separate Income Tax Act was passed. This Act remained in force upto, with various amendments from time to time. In 1918, a new income tax was passed and again it was replaced by another new Act which was passed in 1922. This Act remained in force up to the assessment year 1961-62 with numerous amendments. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India and Sikkim (including Jammu and Kashmir). Since 1962 several amendments of far-reaching nature have been made in the Income Tax Act by the Union Budget every year.

### Income tax

Annual charge levied on both earned income (wages, salaries, commission) and unearned income (dividends, interest, rents). In addition to financing a government's operations, progressive income taxation is designed to distribute wealth more evenly in a population and to serve as automatic fiscal stabilizer to cushion the effects of economic cycles. Its two basic types are (1) Personal income tax, levied on incomes of individuals, households, partnerships, and sole-proprietorships; and (2) Corporation income tax, levied on profits (net earnings) of incorporated firms. However, presence of tax loopholes (whose number increases in direct proportion to the complexity of tax code) may allow some wealthy persons to escape higher taxes without violating the letter of the tax laws.

Jagannathramanujdas v. State of Orissa AIR 1954

Supreme Court held "a tax is undoubtedly in nature of a compulsory exaction of money by public authority for public purpose"

## important concepts in income tax

Income: Income is money that an individual or business receives in exchange for providing a good or service or through investing capital

undersection 2(24) "income"includes—



- (i) profits and gains;
- (ii) dividend;
- (iii) the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17;
- (iv) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;
- (v) any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 or section 41 or section 59;
- (vi) any capital gains chargeable under section 45;
- (vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule;

In Commissioner of Income-tax v. S. S. Haw Wallace and Company 1923 Sir George Lowndes defined income as follows

“Income, in this Act connotes a periodical monetary return " coming in" with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall.”

Agricultural income

As per section 2(1A), agricultural income generally means:

- (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.
- (b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.
- (c) Any income attributable to a farm house subject to satisfaction of certain conditions

specified in this regard in section 2(1A).

Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

Mustafa Ali Khan v/s CIT 1948 : Held, rent of agricultural land received from subtenant by mortgage in possession is agricultural income

CIT v. Scidanbaran Pillai (1970): Held, share of profit of a partner from firm engaged in agricultural operation is agricultural income

Following is not agricultural income

- a) Income from poultry farming.
- (b) Income from bee hiving.
- (c) Income from sale of spontaneously grown trees.
- (d) Income from dairy farming.
- (e) Purchase of standing crop.
- (f) Dividend paid by a company out of its agriculture income.
- (g) Income of salt produced by flooding the land with seawater.
- (h) Royalty income from mines.
- (i) Income from butter and cheese making.
- (j) Receipts from TV serial shooting in farmhouse is not agriculture income.

Certain points to be remembered;

- (a) Agricultural income is considered for rate purpose while computing tax of Individual/HUF/AOP/BOI/Artificial Judicial Person.
- (b) Losses from agricultural operations could be carried forward and set off with agricultural income of next eight assessment years.

(c) Agriculture income is computed same as business income.

## **Assessee Section 2(7)**

Is a noun derived from verb “assess” dictionary meaning of which is “to evaluate or estimate the value”

" assessee" means a person by whom any tax or any other sum of money is payable under this Act, and includes-

(a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;

(b) every person who is deemed to be an assessee under any provision of this Act;

(c) every person who is deemed to be an assessee in default under any provision of this Act; CIT v/s udhoji Shri Krishanadas (M.P high court, 2004)

Held from section 2(7), it is clear that term assessee includes actual as well as deemed assesses under provisions of Act.

## **Assessment year S.2(9) Income Tax**

Assessment year is basically a 12 months period starting from April 1, during which an assessee +is required to file the return of income (ITR) and the ITO has to initiate assessment proceedings for income as per ITR and tax thereon. Since Income Tax is on income of a financial/ previous year or period, so tax filings and assessment can start thereafter. Probably, that's why it's called assessment year/ period.

As per S.2(9) of the Income Tax Act, 1961, unless the context otherwise requires, the term “assessment year” means the period of twelve months commencing on the 1st day of April every year

What is the difference between Financial Year and Assessment Year?



AY is the assessment year and FY is the financial year. From an income tax perspective, FY is the year in which you earn an income. AY is the year following the financial year in which you have to evaluate the previous year's income and pay taxes on it.

For example, if your financial year is from 1 April 2015 to 31 March 2016, then it is known as FY2015-16. The assessment year for income earned during this period would begin after the financial year ends—that is on 1 April 2016 till 31 March 2017. Hence, the assessment year would be AY2016-17.

## **Previous Year: S.2(34) Income Tax**

Previous basically indicates an event previous to another event. Under Income Tax main event is assessment, i.e. filings by assesseees and their review by the ITO, which may start after end of the year / period during which earnings are made and that period is called previous year / financial year. Those earnings are subjected to tax in the following period / year which is called assessment year / period.

As per S.2(34) of Income Tax Act, 1961, unless the context otherwise requires, the term “previous year” means the previous year as defined in section 3.

In view of above, we need to visit definition of previous year under Section 3 also, as under:

As per S.3 of Income Tax Act, 1961, for the purposes of this Act, the term “previous year” means the financial year immediately preceding the assessment year.

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

What is the difference between previous Year and Assessment Year?

assessment year is the year in which income is evaluated and taxed. This evaluation and taxation is done on income that is earned in the previous year, which is known as the financial year.

## Definition of 'Business'

As per S.2(13) of the Income Tax Act, 1961, unless the context otherwise requires, the term "business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Parimangaldas Girdharidas v/s CIT (1978)

In this case following tests are suggested to ascertain if an activity is business or not-

1. Whether the initial acquisition of the subject matter of transaction was with intention of dealing in item in question or with a view to finding an investment?
2. The purpose, manner and object of subsequent sale
3. The manner in which the assessee dealt with the subject matter of transaction.
4. The manner of filing return of income from such source by assessee.
5. The volume, frequency, continuity and regularity of transactions of purchase
6. In case of partnership firms or companies; whether the partnership deed or memorandum of association authorized the firm or company to purchase and/or sell the commodity in question.

## Dividend Section 2(22)

Dividend refers to a reward, cash or otherwise, that a company gives to its shareholders. Dividends can be issued in various forms, such as cash payment, stocks or any other form. A company's dividend is decided by its board of directors and it requires the shareholders' approval. However, it is not obligatory for a company to pay dividend. Dividend is usually a part of the profit that the company shares with its shareholders

After paying its creditors, a company can use part or whole of the residual profits to reward its shareholders as dividends. However, when firms face cash shortage or when it needs cash for reinvestments, it can also skip paying dividends. When a company announces dividend, it also fixes a record date and all shareholders who are registered as of that date become eligible to get dividend payout in proportion to their shareholding.

The term dividend is not defined under the ACT. Under Section 2(22) following income is included in dividend-



"dividend" includes-

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

(b) any distribution to its shareholders by a company of debentures, debenture- stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;

(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933 , whether such accumulated profits have been capitalised or not;

(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987 , by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern, in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)] or any payment by any such company on behalf, or for- the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits; but " dividend" does not include--

(i) a distribution made in accordance with sub- clause (c) or sub- clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets;

(ia) a distribution made in accordance with sub- clause (c) or sub- clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares

allotted to its equity shareholders after the 31st day of March, 1964, and before the 1st day of April, 1965];]

(ii) any advance or loan made to a shareholder or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company;

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off. Explanation 1- The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956. Explanation 2.-- The expression "accumulated profits" in sub-clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in subclause (c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place]. Explanation 3.- For the purposes of this clause,-

(a) "concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern;]

Capital Asset [section 2(14)]

capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include-

(i) any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;

(ii) For personal effects, that is to say, movable property (including wearing apparel and furniture, but excluding jewellery) held for personal use by the assessee or any member of his

family dependent on him. Explanation.- For the purposes of this sub- clause," jewellery" includes-

(a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semiprecious stone, and whether or not worked or sewn into any wearing apparel;

(b) precious or semi- precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;]

(iii) agriculturallandin India,not beinglandsituate-

(a) in any area which is comprised within the jurisdiction of a municipality (whether known asamunicipality,municipalcorporation,notifiedareacommittee,townareacommittee,town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(b) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette;]

(iv) 6 per cent Gold Bonds, 1977 , or 7 per cent Gold Bonds, 1980 ,] or National Defence Gold Bonds, 1980 ,] issued by the Central Government;]

(V)SpecialBearer Bonds,1991 , issuedbythe Central Government;]

## **Person[section 2(31)]**

person"includes-

(i) anindividual,

(ii) aHindu undivided family,

(iii) acompany,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,



(vi) local authority, and

(vii) every artificial juridical person, not falling within any of the preceding sub-clauses;

(i) Individual. It refers to a natural human being whether male or female, minor or major.

(ii) Hindu Undivided Family. It is a relationship created due to operation of Hindu Law. The manager of HUF is called "Karta" and its members are called 'Coparceners'.

(iii) Company. It is an artificial person registered under Indian Companies Act 1956 or any other law.

(iv) Firm. It is an entity which comes into existence as a result of partnership agreement between persons to share profits of the business carried on by all or any one of them. Though, a partnership firm does not have a separate legal entity, yet it has been regarded as a separate entity under Income Tax Act. Under Income Tax Act, 1961, a partnership firm can be of the following two types

(i) a firm which fulfills the conditions prescribed under/s 184.

(ii) A firm which does not fulfill the conditions prescribed under/s 184.

It is important to note that for Income Tax purposes, a limited liability partnership (LLP) constituted under the LLP Act, 2008 is also treated as a firm.

(v) Association of Persons or Body of Individuals.: Co-operative societies, MARKFED, NAFED etc. are the examples of such persons. When persons combine together to carry on a joint enterprise and they do not constitute partnership under the ambit of law, they are assessable as an association of persons. Receiving income jointly is not the only feature of an association of persons. There must be common purpose, and common action to achieve common purpose i.e. to earn income. An AOP. can have firms, companies, associations and individuals as its members.

A body of individuals (BOI) cannot have non-individuals as its members. Only natural human beings can be members of a body of individuals.

Whether a particular group is AOP. orBOL.is a question of fact to be decided in each case separately.

(vi) Local Authority. Municipality, Panchayat, Cantonment Board, Port Trust etc. are called local authorities.

(vii) Artificial Juridical Person. A public corporation established under special Act of legislature and a body having juristic personality of its own are known to be Artificial Juridical Persons. Universities are an important example of this category.

## **Charge of income-taxes(4).**

(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :

Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.

(2) In respect of income chargeable under sub-section(1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

Balmukund Acharyavvs DCIT(2009)

Where the assessee erroneously offered capital gains to tax and the same was accepted by the AO vide Intimation u/s 143 (1)(a) and the assessee thereafter filed an appeal against such assessment of capital gains and the same was held not maintainable by the Tribunal, HELD, reversing the order of the Tribunal that:

(1) In view of the Explanation to s. 143 (prior to its deletion w.e.f. 1.6.1999) an Intimation is deemed to be an appealable order and appeal is maintainable;

(2) The authorities under the Act are under an obligation to act in accordance with law. Tax can be collected only as provided under the Act. If any assessee, under a mistake, misconceptions or on not being properly instructed is over assessed, the authorities under the Act are required to assist him and ensure that only legitimate taxes due are collected. If

particular levy is not permitted under the Act, tax cannot be levied applying the doctrine of estoppel.

## Residential status of Assessee

Income tax is imposed on the basis of duration of residence of assessee in India. Citizenship is not a precondition for liability to income tax. Subject of income tax is a person as defined under the Income Tax Act, depending on his residence in India and not citizen.

Section 5 in The Income-Tax Act, 1995

Scope of total income

(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which-

- (a) is received or is deemed to be received in India in such year by or on behalf of such person; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) accrues or arises to him outside India during such year: Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which-

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1- Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India. Explanation 2.- For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that

it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

#### Residential status of Assessee

the residential status of an assessee as defined in income tax act 1961. the residential status will be helpful in determining the taxable income in India. Residential status of an assessee is defined in Section 6 Of Income Tax Act, 1961.

The residential status of an assessee is classified into two parts:

1. Resident
2. Non- Resident

#### Residential Status of an Individual and HUF

An Individual & HUF which are residents are further classified under two headings:

- Ordinarily resident
- Not Ordinarily resident

Now we are going to understand the residential status assessee wise. Residential

#### Status of an Individual

##### Who will be Indian Resident Individual?

According to section 6(1) of the I.T. Act, 1961 an individual can be treated as Resident Indian in the previous year if he fulfils any of the following conditions:

Condition 1 – He is in India in the previous year for a period of 182 days or more or

Condition 2 – He is in India in the preceding four years for a period of 365 days or more & he is in India in the previous year for a period of 60 days or more

Special condition for Indian Citizen – The residential status of an individual who is citizen of India rendering service outside India & who visit India during leave or vacations in the previous year or an individual who is citizen of India or a person of Indian origin is outside

India & comes to India for visit in the previous year will be treated as resident in India if he stays in India for a period of 182 days or more in the previous year (instead of 60 days or more).

Amendment in Budget 2015

Following Clause have been inserted by Finance Bill-2015 in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed.”

Who will non resident Individual?

The Individual who does not satisfies both the conditions laid down under section 6(1) then he will be treated as Non Resident Indian. The Individual which satisfy any of the conditions mentioned under section 6(1) then he will be treated as resident Indian & he is further classified either as Ordinarily resident Or Not Ordinarily Resident.

According to section 6(6)(a) of I. T. Act, 1961 a Resident Individual will be treated as Not Ordinarily resident if he satisfies both of the following conditions:

- He is Non resident for a period of 9 out of 10 Preceding years of the previous year or
- He is India for a period of 729 days or less in immediately preceding 7 Years of the previous year.

The Resident Individual Who does not satisfy any of the conditions mentioned in section 6(6)(a) will be treated as Ordinarily Resident.

Example to determine residential status of an assessee

Mr. Akshayan Indian citizen Comes to visit India on 1<sup>st</sup> April, 2014 & left India on 02<sup>nd</sup> Oct, 2014.

Further he is in India for following days in following years:

2008-09: 130 days

2009-10:150 days

2010-11:165 days

2011-12:158 days

2012-13:147 days

2013-14:49 days

In the above example the residential status of Mr. Akshay for Previous year 2014-15 is Resident but Ordinarily resident in India because he is in India in the previous year for a period of 182 days or more i.e. 185 days (1<sup>st</sup> April to 2<sup>nd</sup> Oct). & he is treated as Ordinarily resident because he does not satisfy all of the conditions mentioned under section 6(6).

#### ResidentialStatus of anHindu Undivided Family(HUF)

A Hindu Undivided Family will be treated as Non Resident in India if during that previous year the control & management of its affairs is situated wholly outside India. If the above condition is not satisfied then he will be treated as Resident in India.

According to section 6(6)(b) of I. T. Act, 1961 a Resident Hindu Undivided Family will be treated as Not Ordinarily resident if he satisfies both of the following conditions:

- If the Manager of HUF is Non resident for a period of 9 out of 10 Preceding years of the previous year or
- Manager of HUF is in India for a period of 729 days or less in immediately preceding 7 Years of the previous year.

The Resident HUF Who does not satisfy any of the conditions mentioned in section 6(6)(b) will be treated as Ordinarily Resident.

#### ResidentialStatusofanCompany:

According to section 6(3) of I. T. Act, 1961 a company is said to be resident in India if it satisfies any of following two conditions:

- It is an Indian Company or
- The control & management of the company is wholly situated in India during that previous year
- If both the above conditions are not satisfied then such company is treated as Non Resident Company.

Finance Budget 2015 : From 1<sup>st</sup> April, 2016 a company is said to be resident in India if it satisfies any of following two conditions:

- It is an Indian Company or
- Its place of effective management, at any time in previous year, is in India

Explanation.—For the purposes of this clause “place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.’.

If both the above conditions are not satisfied then such company is treated as Non Resident Company.

Residential Status of a Firm & Other associations of Persons:

Firm & Other association of persons will be treated as Non Resident in India if during that previous year the control & management of its affairs is situated wholly outside India. If the above condition is not satisfied then he will be treated as Resident in India.

Vijaymalias vs Assistant Commissioner High court of Calcutta, (2003)

Held, while deciding the residential status of an assessee the AO should consider the provisions of both section 6(1)(a) and section 6(1)(c) of the said Act and this is mandatory requirement of law. An assessee may not be ordinary resident of India under section 6(1)(a) but may be resident under section 6(1)(c) of said Act.

Also refer to: CIT and Anr. V. Morgenstern Werner

Subbayachettair vs CIT 1951

Following propositions are stated in this case:

- I. Generally HUF shall be taken to be resident in india unless control and management of its affairs are situated wholly outside india
- II. control and management means actual control and management and not merely the right to control and manage
- III. place of residence and place of business of HUF
- IV. occasional visits by a non resident 'karta' to the place of HUF business in india is not sufficient to make HUF ordinarily resident in india.

## Deemed Income

Such incomes which are not actually received by a person, but law considers them as receipt or incomes, are called incomes deemed to be received in India. The term 'Statutory receipts' can be easily used to cover this term. Following are the instances of incomes deemed to be received

- (i) Tax deducted at source is income deemed to be received by a person even though he never receives such income (u/s 198).
- (ii) Section 7 considers the following incomes as deemed to be received by an assessee
  - (a) Employer's contribution to Recognised provident fund in excess of 12% of salary of employee [Section 7(i)1.
  - (b) Interest accrued on recognised provident fund balance in excess of 9.5% p.a. [Section 7(i)].
  - (c) Taxable portion of transferred balance of URPF to RPF [Section 7(u)].
  - (d) The contribution made, by the Central Government in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD [Section 7(iii)].
- (iii) Transfer of income without transfer of assets is deemed to be the income of transferor u/s 60 and 61.
- (iv) Under section 8, the dividend distributed or deemed to be distributed u/s 2(22) will be deemed to be distributed in the previous year.

(v) Income from undisclosed sources [Sections 68, 69, 69A, 69B, 69C and 69D].





## Module 2

विद्या अनन्तम्

## Understanding Residential Status and Its Role in Taxation

### Introduction

The concept of residential status is foundational in the Indian tax system, as it directly determines the scope and extent of an individual's or entity's tax liability in India. Unlike many other countries where citizenship may dictate tax liability, India's Income Tax Act, 1961, bases taxation primarily on the residential status of the taxpayer. This status is determined for each financial year (April 1 to March 31), and it affects whether global income or only Indian-sourced income will be taxed. Therefore, understanding how residential status is established is essential for both compliance and effective tax planning.

### Meaning of Resident and Non-Resident

#### Resident

An individual is classified as a resident in India if they satisfy at least one of the following two conditions:

The individual is present in India for 182 days or more during the relevant financial year; OR

The individual is present in India for at least 60 days during the financial year AND for at least 365 days during the preceding four financial years.

If either of these conditions is met, the individual is considered a resident for tax purposes. There are exceptions for Indian citizens or persons of Indian origin who come on a visit to India, where the 60 days in the second condition is extended to 182 days.

#### Non-Resident

A non-resident is an individual who does not meet any of the above conditions. Non-residents are only subject to tax on income that is received, accrues, or arises in India. Their foreign income is not taxed, providing a narrower tax base.

### Resident and Ordinarily Resident vs. Resident but Not Ordinarily Resident

#### Resident and Ordinarily Resident (ROR)

Once an individual is determined to be a resident, it is further necessary to check whether they are "ordinarily" or "not ordinarily" resident. An individual is classified as a Resident and Ordinarily Resident if:

They have been a resident in India for at least 2 out of the 10 preceding years, and

They have been present in India for at least 730 days during the preceding 7 years.

An ROR is taxed on their global income, meaning all income, whether earned or received in India or abroad, is subject to taxation in India.

#### Resident but Not Ordinarily Resident (RNOR)

An individual who is a resident in the current year but does not satisfy both of the above conditions is regarded as “Resident but Not Ordinarily Resident.” RNORs have a limited tax liability compared to RORs. Their taxable income includes:

Income received or deemed to be received in India,

Income accruing or arising in India,

Income accruing outside India from a business controlled from or a profession set up in India.

Their other foreign income is not taxable in India.

#### Determining Residential Status

The Income Tax Act prescribes specific rules for different types of taxpayers. Here’s how residential status is determined:

##### Individuals

Residential status for individuals is based primarily on the number of days they are physically present in India during the financial year and the preceding years, as detailed above.

##### Hindu Undivided Families (HUFs)

For HUFs, the key factor is the location of control and management of family affairs. If the control and management are wholly or partly situated in India during the year, the HUF is treated as a resident. If the control and management are entirely outside India, the HUF is considered non-resident.

##### Firms and Companies

**Firms & Other Associations of Persons (AOPs):** A firm or AOP is resident in India if the control and management of its affairs are wholly or partly situated in India.

**Companies:** A company is resident in India if it is incorporated in India, or if its place of effective management (POEM) during the year is in India. POEM means the place where key management and commercial decisions necessary for the conduct of the business as a whole are made.

##### Other Persons

For trusts, societies, and other entities, the principle of control and management applies. If the affairs are controlled and managed from India, they are treated as residents; otherwise, non-residents.

#### Scope of Total Income Based on Residential Status

The residential status directly impacts which incomes are included in the taxable total income:

##### Residents and Ordinarily Residents (ROR):

Taxable Income: All income earned or received anywhere in the world, including India.

Examples: Salary from a job in the U.S., rental income from property in India, income from foreign investments — all taxable in India.

##### Residents but Not Ordinarily Residents (RNOR):

Taxable Income: Income received, accrued, or arising in India; and income from businesses or professions controlled from India.

Exempt: Other foreign incomes are not taxable.

##### Non-Residents (NR):

Taxable Income: Only income that is received in India, accrues or arises in India, or is deemed to accrue or arise in India.

Exempt: All foreign income (not linked to India) is exempt.

#### Types of Income Relevant for Taxation

##### Income Received in India

This refers to any income actually received by the taxpayer in India, regardless of where it was earned. Physical receipt in India is the criterion, not the source of the income.

Example: A foreign salary directly credited to an Indian bank account is considered income received in India.

##### Income Deemed to be Received in India

Certain incomes are treated as received in India by law, even if not physically received. Examples include contributions made by an employer to an employee's provident fund or transferred income to a retirement account.

Example: Employer's contribution to an employee's recognized provident fund is treated as income received by the employee.

### Income Accruing or Arising in India

This refers to income that is earned due to a source or activity located in India. It does not matter if the payment is received elsewhere.

Example: Rental income from property in India, even if collected abroad, is income accruing in India.

### Income Deemed to Accrue or Arise in India

The law specifies certain incomes that, while not actually accruing in India, are treated as such for taxation. This includes:

Income from business connections in India,

Income from assets or sources located in India,

Salaries paid by the Government of India to citizens for services outside India,

Fees for technical services, interest, dividends, and royalties paid by an Indian resident or government, subject to certain conditions.

Example: A royalty paid by an Indian company to a foreign company for using patents in India is deemed to accrue in India, even if paid abroad.





## Module 3

विद्या अनन्तम्

# Section 10 – Tax Exemptions, Allowances & How to Claim Them

Section 10 of the Income Tax Act, 1961 lists various incomes that are **fully or partially exempt from tax**. These exemptions reduce the taxable income of the taxpayer. Many of these benefits apply mainly under the **old tax regime**, introduced before 2020.

Disclosure of exempt income in the ITR is **mandatory**.

## Common Exemptions Under Section 10

- House Rent Allowance (HRA)
- Leave Travel Allowance (LTA)
- Agricultural income
- Interest from Provident Fund (subject to limits)
- Gratuity and retirement benefits
- Income from life insurance
- Partner's share of profits
- Certain types of interest, dividends and capital gains
- SEZ unit income (Section 10AA)

## Categories of Section 10 Exemptions

### 1 □ Exempt Allowances (Salary Income)

#### Section 10(13A): House Rent Allowance (HRA)

Part of the salary given to meet rent expenses is exempt up to the **least of**:

1. Actual HRA received
2. 50% of salary (Basic + DA) — Metro cities  
40% for non-metros
3. Rent paid – 10% of salary

#### Example

Employee in Mumbai  
Basic salary = ₹40,000/month  
HRA received = ₹20,000/month  
Rent paid = ₹15,000/month

Condition	Amount
Actual HRA	₹2,40,000
50% of salary	₹2,40,000
Rent – 10% salary	₹1,32,000

**Exempt = ₹1,32,000**

**Taxable HRA = ₹1,08,000**

Allowed only if rent is paid.

### **Section 10(5): Leave Travel Allowance (LTA)**

Covers **domestic travel fare only** (air/train/bus) for employee and family.

Not covered:

- ✗ Hotel
- ✗ Local travel
- ✗ Food

Allowed twice in a block of 4 years.

### **Section 10(14): Special Allowances**

Exempt if actually spent for official duties.

Examples:

- Travel & conveyance
- Research allowance
- Uniform allowance
- Internet allowance
- Meal allowance (up to ₹26,400/year)

### **Section 10(14)(ii): Children's Education Allowance**

- ₹100/month per child
- Maximum for 2 children

Transport allowance for disabled employee:

- ₹3,200/month

## **Other Exempt Salary-Related Income**

### **Section 10(11): Provident Fund & Sukanya Samriddhi Interest**

Interest is exempt, **except** when:

- Employee PF contributions exceed ₹2.5 lakh/year (taxable interest portion).

### **Section 10(10): Gratuity**

- Fully exempt for Government employees

- Private employees — exempt subject to limits and eligibility

### **Section 10(10AA): Leave Encashment**

<b>Situation</b>	<b>Tax Status</b>
During employment	Fully taxable
At retirement — Govt employee	Fully exempt
At retirement — Non-Govt employee	Exempt up to least of: <ul style="list-style-type: none"> <li>• ₹25,00,000</li> <li>• Leave salary received</li> <li>• 10 months' average salary</li> <li>• Cash equivalent of unavailed leave</li> </ul>

### **Section 10(10A): Commuted Pension**

Fully exempt for Government employees.

### **Section 10(10B): Retrenchment Compensation**

Exempt up to **lower of**:

- ₹5,00,000
- or
- 15 days' average pay × completed years of service

### **Section 10(10C): Voluntary Retirement**

Exempt up to least of:

- ₹5,00,000
- Last drawn salary × months left
- 3 months' salary × years of service

### **Section 10(10D): Life Insurance Payouts**

Maturity proceeds are exempt unless:

- High premium exceeds permitted % of sum assured
- Key-man insurance
- Certain special-purpose policies

## **Exempt Non-Salary Income**

### **Section 10(1): Agricultural Income**

Includes:

- Income from cultivation

- Rent from agricultural land
- Sales of produce
- Farm building income

### **Section 10(2A): Partner's Share of Profit**

Fully exempt  
(Interest & remuneration remain taxable)

### **Section 10(15): Interest on Savings Certificates**

Exempt up to:

- ₹3,500 — individual account
- ₹7,000 — joint account

Applicable on notified securities & Post Office SB interest.

### **Section 10(23C): Educational & Medical Institutions**

Exempt if receipts ≤ ₹5 crore annually

### **Section 10(26): Scheduled Tribe Members — NE States**

Income earned within notified NE states is exempt.

### **Section 10(26AAA): Sikkimese Individuals**

Income arising in Sikkim is exempt.

### **Section 10(34): Dividend Income (till 31-03-2020)**

Dividend up to ₹10,000 exempt — earlier regime only.

### **Section 10(34A): Buy-Back of Shares**

Exempt if received from domestic company **before 01-10-2024**

### **Section 10(35): Specified Mutual Fund Income**

Exempt only up to **31-03-2020**

### **Section 10(37): Capital Gains — Compulsory Acquisition of Urban Agricultural Land**

Conditions:

- Land used for agriculture for previous 2 years
- Acquisition approved by Govt/RBI

## ✓ Section 10(38): LTCG on Listed Equity (till 31-03-2018)

Earlier exempt if STT paid  
(Now taxable)

## Section 10AA — SEZ Units

Available to new SEZ industrial units set up between **01-04-2006 and 31-03-2021**

Deduction allowed:

- 100% of export profit — first 5 years
- 50% — next 5 years
- 50% of retained profits — next 5 years

## How to Claim Section 10 Exemptions

### Step-1: Collect documents

Salary slips  
Form 16  
Rent receipts (for HRA)  
Travel proofs (for LTA)  
PF/interest statements  
Insurance policy details

### Step-2: Compute exempt amount as per Section 10 rules

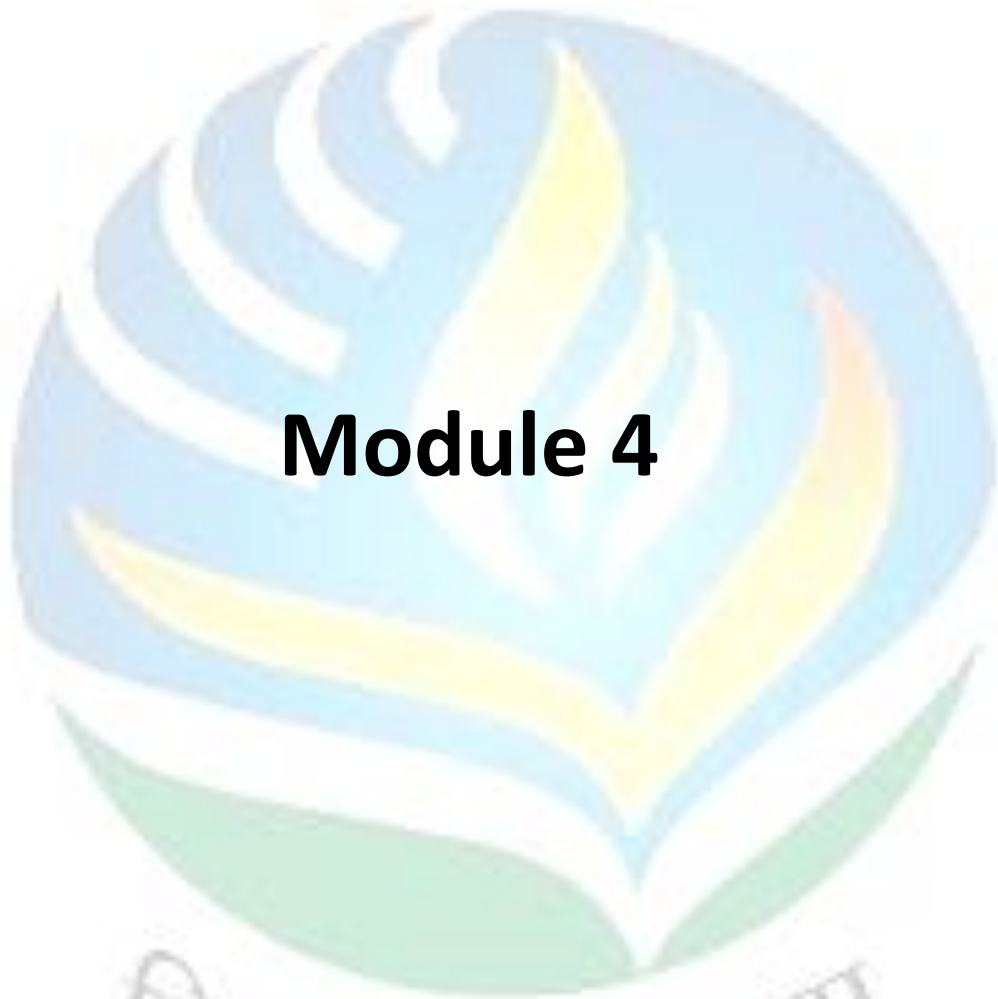
### Step-3: Report income correctly in ITR\*\*

Exempt income must be shown under  
☞ “*Exempt Income (Schedule EI)*”

### Step-4: File correct ITR for\*\*

### Step-5: e-Verify return\*\*

To complete filing process



## Module 4

विद्या अनन्तम्

# Five Heads of Income Under the Income Tax Act

In India, the Income Tax Act classifies a taxpayer's earnings into **five heads of income**. Each head is governed by separate tax provisions and deduction rules. Correct classification is important because it ensures proper tax computation and prevents errors during filing.

## The Five Heads of Income

1. **Income from Salary**
2. **Income from House Property**
3. **Profits and Gains from Business or Profession**
4. **Capital Gains**
5. **Income from Other Sources**

Each head has its own rules for taxation, exemptions and deductions.

## Income from Salary

This head includes income received under an **employer–employee relationship**. It covers:

- Basic salary
- Allowances
- Bonus
- Commission
- Gratuity
- Pension
- Perquisites (benefits)

Relevant legal provisions:

- **Section 15** – Taxability of salary income
- **Section 16** – Deductions from salary
- **Section 17** – Meaning of salary and perquisites

Examples of exemptions

- **House Rent Allowance (HRA)** — subject to limits
- **Transport allowance for specially-abled employees**

Salary income is reported in **Schedule S** of the ITR.

## Income from House Property

This head applies to income earned from **ownership of property**, including buildings and land attached to buildings.

Types of house property

- **Self-occupied**
- **Let-out**
- **Deemed let-out** (if more than two houses are treated as self-occupied)

Tax applies to both **residential and commercial property rents**.

Details are reported in **Schedule HP** of the ITR.

## Profits and Gains from Business or Profession

This head covers income earned through:

- Trade or business
- Professional services
- Speculative activities (e.g., F&O trading)
- Presumptive taxation (Sections 44AD, 44ADA, 44AE)

Expenses incurred **wholly for business purposes** may be deducted from income.

Examples of taxable income

- Profit from sales
- Professional consultancy fees
- Export incentives
- Partnership remuneration & interest
- Trading income

Individuals and HUFs generally file **ITR-3 or ITR-4** (depending on scheme opted).

## Income from Capital Gains

Capital gains arise when a **capital asset is transferred**, such as:

1. Real estate
2. Gold
3. Shares
4. Mutual funds
5. Bonds

Capital gains are classified as:

- **Short-Term Capital Gain (STCG)**
- **Long-Term Capital Gain (LTCG)**
- Tax rates vary based on:
  - Holding period
  - Type of asset
  - Date of sale

Capital gain details are declared in **Schedule CG**.  
Individuals normally use **ITR-2 or ITR-3**.

## Income from Other Sources

This is a **residual head** that covers income not falling under the first four heads.

### Examples

- Interest from deposits
- Dividends
- Lottery winnings
- Rent of machinery/plant
- Casual income such as prizes, gambling etc.

Such income must be reported separately in the ITR.

## Heads of Income vs Sources of Income (Difference)

### Heads of Income

→ Legal classification of income for tax computation

Includes:

- Salary
- House Property
- Business/Profession
- Capital Gains
- Other Sources

### Sources of Income

→ Actual ways income is earned

Examples:

- Salary received from employer

- Bank interest
- Business profits

## Key Features of Taxation

1. Taxes exist in multiple forms — including direct and indirect taxes.
2. Payment of tax is compulsory for eligible taxpayers.
3. Taxes are collected periodically.
4. Tax revenue funds public expenditure.
5. Taxpayers do not receive a direct benefit equal to the tax paid.



# GOKUL GLOBAL UNIVERSITY

Faculty of Commerce & Management

E-Content



<b>Course:</b>	Bachelor of Business Administration
<b>Semester:</b>	03
<b>Subject:</b>	COST ACCOUNTING – I
<b>Subject Code:</b>	FMB230104

**Address:** -Gokul Global University, SujanpurPatia, Opp. I.O.C. Depot.  
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**Prepared By:** Mr. Shamim A Sulemani

## Bachelor of Business Administration (BBA)

**Programme:** Bachelor's of Business Administration

**Subject / Branch:** Management

**Year:** Second Year

**Semester:** III

**Course Title:** COST ACCOUNTING – I

**Course Code:** FMB230104

**Course Type:** Core Compulsory

**Course Credit:** 04

### Pre-Requisite

10+2 (Commerce) or equivalent qualification from a recognized education board.

### Rationale of the Course

The course aims to familiarize students with the **fundamental concepts, techniques, and applications of Cost Accounting**. It provides conceptual clarity as well as practical understanding of cost determination, cost control, and cost analysis, which are essential for managerial decision-making in manufacturing and service organizations.

### Teaching & Examination Scheme

Teaching (Hours per Week)		
Lecture	Tutorial	Practical
4	0	0
Examination Scheme		
Internal (Mid-CE)	External	Total
20	70	100

### Course Objectives

After completing this course, students will be able to:

1. Define and understand the **basic concepts, principles, and terminology** of Cost Accounting.
2. Distinguish between **various types of costs** such as direct and indirect costs, fixed and variable costs, and overheads.
3. Analyze **cost behavior** and apply cost information for effective managerial decision-making.

### Course Outcomes

On successful completion of the course, students will be able to:

1. Understand the **concept, scope, and importance** of Cost Accounting.
2. Prepare and interpret **cost sheets** from a practical perspective.
3. Apply knowledge of **material control techniques and pricing methods**.
4. Identify and classify costs such as **direct, indirect, fixed, and variable costs** in business situations.

## Course Content & Unit-wise Details

### Unit I: Introduction to Cost Accounting

**Credit Weightage:** 1 Credit | **Marks:** 25%

- Meaning and definition of Cost Accounting
- Need and objectives of Cost Accounting
- Advantages and limitations of Cost Accounting
- Cost Accounting vs Financial Accounting
- Cost concepts and cost objects
- Elements of cost
- Classification of costs
- Methods of costing
- Techniques of costing (with special emphasis on **Uniform Costing**)
- Cost centre and cost unit
- Installation of a good Cost Accounting System

### Unit II: Materials

**Credit Weightage:** 1 Credit | **Marks:** 25%

- Definition of inventory
- Meaning of materials and material control
- Objectives, necessity, and advantages of material control
- Purchase procedure and stores routine
- Inventory control techniques:
  - Economic Order Quantity (EOQ)
  - Determination of stock levels
  - Just-In-Time (JIT)
  - ABC analysis
- Methods of pricing issues of materials:
  - FIFO
  - LIFO
  - Base Stock Method
  - Weighted Average Method
  - Periodic Weighted Average Method
  - Standard Price
  - Replacement Price

## Unit III: Labour

**Credit Weightage:** 1 Credit | **Marks:** 25%

- Direct and indirect labour cost
- Labour cost accounting and labour records
- Methods of remuneration:
  - Time wage system
  - Piece wage system
- Bonus and incentive plans:
  - Halsey Premium Plan
  - Rowan Plan
  - Taylor's Differential Piece Rate System
  - Bedeaux Plan
  - Merrick's Multiple Piece Rate System
  - Gantt Task and Bonus System
  - Profit sharing and co-partnership
- Requisites of a good wage incentive plan
- Labour turnover: causes, cost, and treatment
- Idle time: meaning and accounting treatment
- Overtime premium
- Casual workers and out-workers
- Holiday and leave with pay
- Cost of apprentice
- Employee welfare cost and fringe benefits
- Bonus and gratuity

## Unit IV: Overheads and Activity Based Costing

**Credit Weightage:** 1 Credit | **Marks:** 25%

### A. Overheads

- Meaning and definition of overheads
- Classification of overheads
- Segregation of semi-variable overheads
- Cost allocation and cost apportionment
- Bases of apportionment of factory overheads
- Re-apportionment of service department costs
- Absorption of overheads based on:
  - Direct material cost
  - Direct labour cost
  - Prime cost
  - Labour hours
  - Machine hours
- Over-absorption and under-absorption of overheads
- Treatment of setting-up time and idle time

- Absorption of administration, selling, and distribution overheads (theory only)

### **B. Activity Based Costing (Conceptual Understanding)**

- Meaning and features of Activity Based Costing (ABC)
- Difference between traditional costing and ABC
- Advantages and limitations of ABC

### **Reference Books**

1. Maheshwari, Yogesh – *Managerial Economics*, PHI Learning, New Delhi
2. Gupta G.S. – *Managerial Economics*, Tata McGraw-Hill, New Delhi
3. Geetika, Ghosh & Choudhury – *Managerial Economics*, Cengage Learning
4. *Managerial Economics*, Tata McGraw-Hill, New Delhi

### **Suggested Readings**

1. Dr. P. C. Tulsian – *Cost Accounting*, S. Chand
2. Dr. Murthy & S. Gurusamy – *Cost Accounting*, McGraw-Hill Education

### **Online Resources**

- <https://www.pdfdrive.com>
- <https://www.slideshare.net>

### **Practical / Activities**

1. **Online Quiz** using Google Forms / Google Quizzes
2. **Breakout Room Activity:**
  - Numerical problem solving on cost sheet, material pricing, labour incentives, and overhead absorption



## **MODULE 1**

विद्या अनन्तम्

## **Meaning and Definition of Cost Accounting**

### **Meaning**

Cost Accounting is a specialized branch of accounting that focuses on the systematic recording, classification, analysis, and control of costs incurred in the production of goods or the rendering of services. It provides detailed information about material, labour, and overhead costs involved in various business activities. By identifying the cost of each product, process, or service, cost accounting helps management understand how much it actually costs to produce a unit of output.

Cost accounting also assists management in cost control and cost reduction by highlighting areas of wastage, inefficiency, or excessive expenditure. Through techniques such as standard costing, budgetary control, and variance analysis, it enables managers to compare actual costs with expected costs and take corrective action wherever necessary. Thus, cost accounting serves as an important internal management tool for improving efficiency, profitability, and operational performance.

### **Definition**

Cost Accounting may be defined as the process of accounting for costs which involves the collection, recording, classification, analysis, and interpretation of cost data. The purpose of this process is to present cost information in a systematic and meaningful manner so that it can be effectively used for planning, controlling operations, and managerial decision-making.

According to accepted accounting principles, cost accounting not only determines the cost of products and services but also provides valuable information for pricing decisions, cost control, performance evaluation, and future planning. By supplying accurate and timely cost data, cost accounting helps management make informed decisions regarding production methods, resource allocation, and profitability improvement.

### **Need and Objectives of Cost Accounting**

Cost Accounting has become an essential tool for modern business organizations due to increasing competition, rising costs, and the need for efficient management. It provides detailed cost information that supports planning, control, and decision-making at various levels of management.

### **Need for Cost Accounting**

Cost Accounting is needed for the following reasons:

#### **1. Increasing Business Competition**

In today's competitive business environment, firms face intense competition at local, national, and global levels. To survive and grow, businesses must control costs and offer products at competitive prices. Cost accounting helps organizations analyze costs accurately and remain competitive in the market.

#### **2. Requirement of Accurate Cost Data by Management**

Management needs reliable and detailed cost information to make effective decisions related to production,

pricing, expansion, and cost control. Cost accounting provides precise data regarding material, labour, and overhead costs, which is not available in financial accounting alone.

### **3. Scientific Fixation of Prices**

Prices cannot be fixed arbitrarily. They must be based on accurate cost information to ensure profitability and market competitiveness. Cost accounting helps in scientific price fixation by determining the true cost of production and adding an appropriate margin of profit.

### **4. Control of Wastage and Inefficiency**

Wastage of materials, idle labour time, and inefficient use of resources increase production costs. Cost accounting identifies areas of wastage and inefficiency through techniques like standard costing and variance analysis, enabling management to take corrective measures.

### **5. Importance of Profit Planning**

Modern businesses focus not only on earning profits but also on planning and improving profitability. Cost accounting helps in estimating costs, setting profit targets, and monitoring performance to ensure that desired profit levels are achieved.

## **Objectives of Cost Accounting**

The main objectives of cost accounting are as follows:

### **1. Ascertainment of Cost**

A key purpose of cost accounting is to find out how much it actually costs to produce a product or offer a service. This means collecting and analysing all expenses related to production, such as the cost of materials, wages paid to workers, and factory overheads. These costs may be calculated for each unit, job, batch, or process.

When the true cost is known, the business can fix selling prices more accurately. It also becomes easier to identify costly activities and control waste. Without cost ascertainment, management cannot judge whether a product is profitable or not.

### **2. Cost Control**

Cost control refers to the process of ensuring that the actual costs do not exceed the planned or standard costs. First, budgets and cost standards are set for various activities. Later, the actual expenditure is compared with the planned figures.

If there is a difference, management analyses the reasons — such as wastage, inefficiency, higher prices, or poor supervision. Based on this analysis, corrective steps are taken to keep expenses within reasonable limits. Thus, cost control helps in improving operational efficiency and avoiding unnecessary spending.

### **3. Cost Reduction**

Cost reduction focuses on **permanently decreasing the cost of production** while maintaining the quality of the product or service. Unlike cost control, which only prevents overspending, cost reduction aims to achieve long-term savings.

This may involve:

- using improved technology
- redesigning products
- reducing waste
- increasing labour efficiency
- better use of machines and materials

The goal is to make production more economical and competitive in the market without lowering quality standards.

#### **4. Profit Measurement**

Cost accounting plays an important role in determining the real profit earned by the business. Profit is calculated by comparing total revenue with total cost. Since cost accounting provides a detailed breakdown of different expenses, it becomes easier to know how much profit is earned from each product, department, or process.

This helps management understand which activities are profitable and which are not. As a result, better decisions can be made regarding expansion, improvement, or discontinuation of certain operations.

#### **5. Aid to Decision-Making**

Cost accounting supplies essential information required for managerial decisions. Business decisions such as fixing prices, evaluating special orders, choosing between manufacturing or outsourcing, or deciding whether to shut down or continue operations during losses, all require accurate cost data.

By comparing alternative choices and analysing costs and benefits, management can select the most profitable option. Hence, cost accounting serves as a powerful decision-making tool.

#### **6. Planning and Budgeting**

Planning means preparing for future activities in advance. Cost accounting supports planning by helping management prepare various budgets, such as production budgets, labour budgets, and overhead budgets.

These budgets:

- guide day-to-day operations
- help forecast expenditure
- ensure proper resource allocation
- provide targets for departments

Later, actual performance is compared with the budget to measure efficiency. Thus, cost accounting encourages disciplined planning and organized growth of the business.

## Cost Accounting vs Financial Accounting

Basis	Cost Accounting	Financial Accounting
Purpose	Cost control and decision-making	Reporting profit and financial position
Users	Management	External users
Period	Can be daily or weekly	Usually yearly
Records	Detailed cost records	Summarized financial records
Legal requirement	Not compulsory	Compulsory by law

## Cost Concepts

Cost concepts explain **how costs are identified, classified, and used** for different managerial decisions. Some important cost concepts are explained below:

### 1. Opportunity Cost

Opportunity cost refers to the **benefit that is sacrificed** when one alternative is chosen over another. It represents the value of the next best option foregone. Although opportunity cost does not involve an actual cash outflow, it is very important in decision-making. For example, if a company uses its own building for production, the rent that could have been earned by leasing it out is an opportunity cost.

### 2. Sunk Cost

A sunk cost is a **past cost that has already been incurred and cannot be recovered** in the future. Since it cannot be changed by current or future decisions, sunk cost is not considered while making managerial decisions. For example, the cost of machinery already purchased is a sunk cost when deciding whether to continue or discontinue production.

### 3. Marginal Cost

Marginal cost is the **additional cost incurred by producing one extra unit of output**. It generally includes

variable costs such as direct materials, direct labour, and variable overheads. Marginal cost is useful for short-term decision-making, pricing decisions, and determining the optimum level of production.

#### 4. Relevant Cost

Relevant cost refers to **future costs that will differ between alternatives** and are therefore important for decision-making. Only those costs that change as a result of a decision are considered relevant. For example, when deciding whether to accept a special order, only the additional costs incurred for that order are relevant.

#### 5. Imputed Cost

Imputed cost is a **theoretical or notional cost** that does not involve actual cash expenditure but is considered for decision-making purposes. Examples include interest on owner's capital or rent on a self-owned building. Although these costs are not recorded in financial accounts, they are useful in evaluating the true cost of operations.

## Cost Object

A **cost object** is anything for which costs are **identified, measured, and accumulated**. It helps management analyze where and how costs are incurred. Cost objects vary depending on the nature of business and management requirements.

Common examples of cost objects include:

- **A Product:** This refers to the total cost incurred in producing a particular product or a range of products. It includes all expenses such as raw materials, labour charges, factory overheads, packaging, and quality checks. The purpose of calculating product cost is to determine the cost per unit so that the selling price can be fixed properly and profitability can be measured. It also helps management compare the cost of different products and identify which ones are more cost-effective.
- **A Service:** In the case of service-based organisations, cost accounting focuses on the expenses involved in providing a particular service. Examples include banking, consultancy, healthcare, transportation, hospitality, etc. Service cost may include salaries of staff, operating expenses, equipment charges, and administrative costs. Calculating service cost helps in deciding service fees, improving efficiency, and ensuring that the organisation earns a reasonable return.
- **A Department:** Sometimes costs are collected and analysed for individual departments within an organisation — such as production, maintenance, marketing, finance, or administration. Department-wise costing helps management understand how much each department contributes to total expenses. It also becomes easier to identify inefficient areas, control spending, allocate budgets properly, and evaluate departmental performance..
- **A Project:** Project costing involves determining the total cost incurred on a specific project, contract, or assignment. Examples include construction of a building, development of software, organising an event, or executing a government contract. Costs such as materials, labour, equipment, and supervision are carefully recorded for the duration of the project. This helps in monitoring progress, ensuring the project stays within budget, and evaluating profitability once it is completed..

## Elements of Cost

- The total cost of a product consists of **three main elements**, namely material cost, labour cost, and expenses.

### 1. Material Cost

Material cost refers to the **cost of raw materials** and components used in the production of goods. It forms a major part of the total production cost, especially in manufacturing industries. Material cost is further divided into direct material and indirect material. Direct material includes those raw materials that can be **easily identified and directly traced** to a specific product, such as wood used in furniture or steel used in machinery. Indirect material includes materials that **cannot be directly traced** to a particular product or are of minor value, such as lubricants, nails, or cleaning supplies used in the factory.

### 2. Labour Cost

Labour cost refers to the **wages and salaries paid to workers** for their physical or mental efforts in the production process. Labour cost is classified into direct labour and indirect labour. Direct labour includes wages paid to workers who are **directly involved in production** and whose work can be clearly traced to a specific product, such as machine operators or assembly workers. Indirect labour includes wages paid to workers who **support the production process** but are not directly involved in manufacturing, such as supervisors, watchmen, and maintenance staff.

### 3. Expenses

Expenses include **all costs other than material and labour** incurred in the production and sale of goods. These are further classified into direct expenses and indirect expenses. Direct expenses are those costs that can be **directly identified with a specific product or job**, such as royalty payments, special design charges, or hire of special equipment. Indirect expenses, also known as overheads, include costs that **cannot be directly traced** to a specific product, such as factory rent, electricity, office expenses, and administrative costs.

The total cost of a product can be expressed as:

**Total Cost = Material Cost + Labour Cost + Expenses**

## Classification of Costs

Costs can be classified on different bases to facilitate better understanding, analysis, and control.

### 1. Classification by Nature

Under this classification, costs are grouped according to their basic nature. Material costs include the cost of raw materials and components, labour costs include wages and salaries, and expenses include all other costs incurred in the production and operation of the business.

### 2. Classification by Function

Under functional classification, costs are grouped based on the **functions of the business**. Production cost includes costs incurred in manufacturing goods, such as raw materials, factory wages, and factory overheads. Administration cost includes costs related to planning, organizing, and managing the business, such as office salaries and administrative expenses. Selling cost includes expenses incurred to promote and sell products, such as advertising and salesmen's salaries. Distribution cost includes expenses incurred in storing, packing, and delivering goods to customers.

### 3. Classification by Behaviour

This classification is based on how costs behave in relation to changes in the level of activity. Fixed costs remain **constant regardless of the level of production**, such as rent and salaries. Variable costs **change directly with the level of output**, such as direct materials and direct wages. Semi-variable costs contain both fixed and variable elements, such as electricity bills or telephone charges.

### 4. Classification by Controllability

Costs can also be classified based on whether they can be controlled by management. Controllable costs are those that **can be influenced or regulated** by the actions of a particular manager or department, such as material usage or labour efficiency. Uncontrollable costs are those that **cannot be influenced** by a particular level of management, such as government taxes or fixed rent.

### 5. Classification by Time

Under time-based classification, costs are divided into historical cost and predetermined cost. Historical cost refers to **actual costs incurred in the past**, which are recorded in accounting books. Predetermined cost refers to **costs estimated in advance**, such as standard costs or budgeted costs, which are used for planning and control.

## Methods of Costing

### 1. Job Costing

Job costing is used when production is done based on specific customer requirements. Each individual job, order, or assignment is treated as a separate cost unit. All expenses such as materials, labour, and overheads are recorded for that particular job only. At the end of the job, the total cost is calculated and compared with the price charged to the customer.

This method is commonly used where every job is different and not produced on a large scale. Examples include printing work, repairing machinery, interior decoration, ship building, furniture making, and other customized products. Job costing helps management understand whether each job is profitable and also helps in quoting accurate prices for future orders.

### 2. Batch Costing

Batch costing is applied when similar items are produced together in groups or batches. Instead of calculating the cost for each unit separately, the total cost of the entire batch is first determined. This total cost is then divided by the number of units in the batch to find the cost per unit.

This method is useful in industries where goods are produced repeatedly in fixed quantities, such as pharmaceutical companies, bakeries, toy manufacturing, and garment production. Batch costing helps reduce cost per unit due to mass production and assists in controlling wastage and maintaining quality.

### 3. Process Costing

Process costing is used in industries where production is continuous and products move through a series of processes or departments before completion. Costs are collected separately for each process, and at the end, the total cost is divided by the number of units produced to obtain the average cost per unit.

This method is suitable for large-scale industries such as cement, sugar, textiles, oil refining, paper, and chemical industries. Since all units produced are almost identical, process costing simplifies cost determination and helps management control costs at each production stage.

#### **4. Contract Costing**

Contract costing is applied to large-scale projects that take a long time to complete and are usually carried out at the customer's site. Each contract is treated as a separate cost unit, and all expenses—such as materials, labour, machinery, subcontracting, and site supervision—are recorded contract-wise.

This system is commonly used in construction of buildings, roads, highways, bridges, flyovers, and dams. Since contracts extend over several months or years, periodic profit calculation and cost monitoring are essential. Contract costing helps management track project expenses, control overruns, and assess profitability.

#### **5. Operating Costing**

Operating costing is used by service-providing organisations to find out the cost of delivering a particular service. Costs are collected and analysed for each type of service activity rather than for physical products. These costs may include salaries, maintenance, fuel, utilities, and administrative expenses.

This method is suitable for bus and transport companies, hospitals, airlines, hotels, power supply undertakings, educational institutions, and public utilities. Operating costing helps determine service charges, evaluate efficiency, and ensure that services are provided at reasonable and sustainable cost levels.

#### **6. Unit Costing**

Unit costing (also known as single or output costing) is applied where a single product is produced continuously on a large scale. The total production cost for a period is divided by the number of units produced to calculate the cost per unit.

This method is commonly seen in industries such as mining, brick manufacturing, cement production, gas and water supply, and flour mills. Since the units produced are identical, unit costing offers a simple and effective way to measure production efficiency and profitability.

### **1. Techniques of Costing**

Costing techniques are tools used by management to control costs and improve efficiency.

#### **2. Standard Costing**

Standard costing involves setting standard costs for materials, labour, and overheads and comparing

them with actual costs. Variances are analyzed to identify reasons for deviations. This technique helps in cost control and performance evaluation.

### 3. **Marginal Costing**

Marginal costing considers only variable costs for decision-making purposes. Fixed costs are treated as period costs and charged to profit and loss account. This technique is useful for pricing decisions, break-even analysis, and short-term planning.

### 4. **Budgetary Control**

Budgetary control involves preparing budgets for various activities and comparing actual performance with budgeted figures. Differences are analyzed and corrective actions are taken. It helps in planning, coordination, and effective control of business operations.

## **Uniform Costing (Special Emphasis)**

### 1. **Uniform Costing**

Uniform costing is a costing technique in which **the same costing principles, methods, and procedures are adopted by different firms belonging to the same industry**. This system ensures uniformity in cost records and reporting, making comparison meaningful and reliable.

### 2. **Features of Uniform Costing**

Uniform costing is based on common costing principles followed by all participating firms. It requires uniform accounting procedures and standardized cost records. Consistency in methods ensures comparability and accuracy of cost data across firms.

### 3. **Advantages of Uniform Costing**

Uniform costing enables comparison of costs and performance between firms in the same industry. It helps in improving efficiency by identifying best practices. The system assists in scientific price fixation and promotes cost awareness. It also encourages healthy competition among firms.

### 4. **Limitations of Uniform Costing**

Uniform costing is difficult to implement due to differences in size and operations of firms. It requires strong cooperation and mutual trust among participating firms. The system may not be suitable for small industries due to high implementation costs and lack of expertise.

## **Cost Centre and Cost Unit**

### **Cost Centre**

A cost centre is a location, department, or person where costs are incurred and collected for control purposes. It helps management identify responsibility for costs. Examples include production department, maintenance department, and service departments.

### **Cost Unit**

A cost unit is a unit of product, service, or time for which cost is measured and expressed. It provides a basis for cost calculation and comparison. Examples include cost per unit, cost per kilogram, cost per kilometer, and cost per hour.

## **Installation of a Good Cost Accounting System**

A good cost accounting system should be simple and flexible so that it can be easily understood and adapted to changes in business conditions, technology, or production methods. A complicated system creates confusion and reduces its usefulness, whereas flexibility allows the system to grow along with the business.

The system must be suitable to the nature of the business. Different industries require different costing methods, so the system should match the size, type, and operations of the organization. A system suitable for a manufacturing unit may not be appropriate for a service organization.

A good cost accounting system should be economical, meaning that the benefits derived from the system should be greater than the cost of operating it. Excessive expenditure on maintaining cost records defeats the purpose of cost accounting.

The system must provide accurate and reliable information. Cost data should be correct, timely, and consistent, as management decisions such as pricing, budgeting, and cost control depend heavily on accurate cost information.

The cost accounting system should be integrated with financial accounting. Both systems should work in coordination to avoid duplication of work and ensure consistency of financial and cost data. Proper integration improves efficiency and reliability of information.

Support from top management is essential for successful installation. Without management's encouragement and cooperation, employees may resist the system. Management support ensures proper implementation and effective use of cost data.

The system should be properly documented, including manuals, procedures, forms, and reports. Clear documentation helps employees understand their roles and ensures uniformity in costing practices.

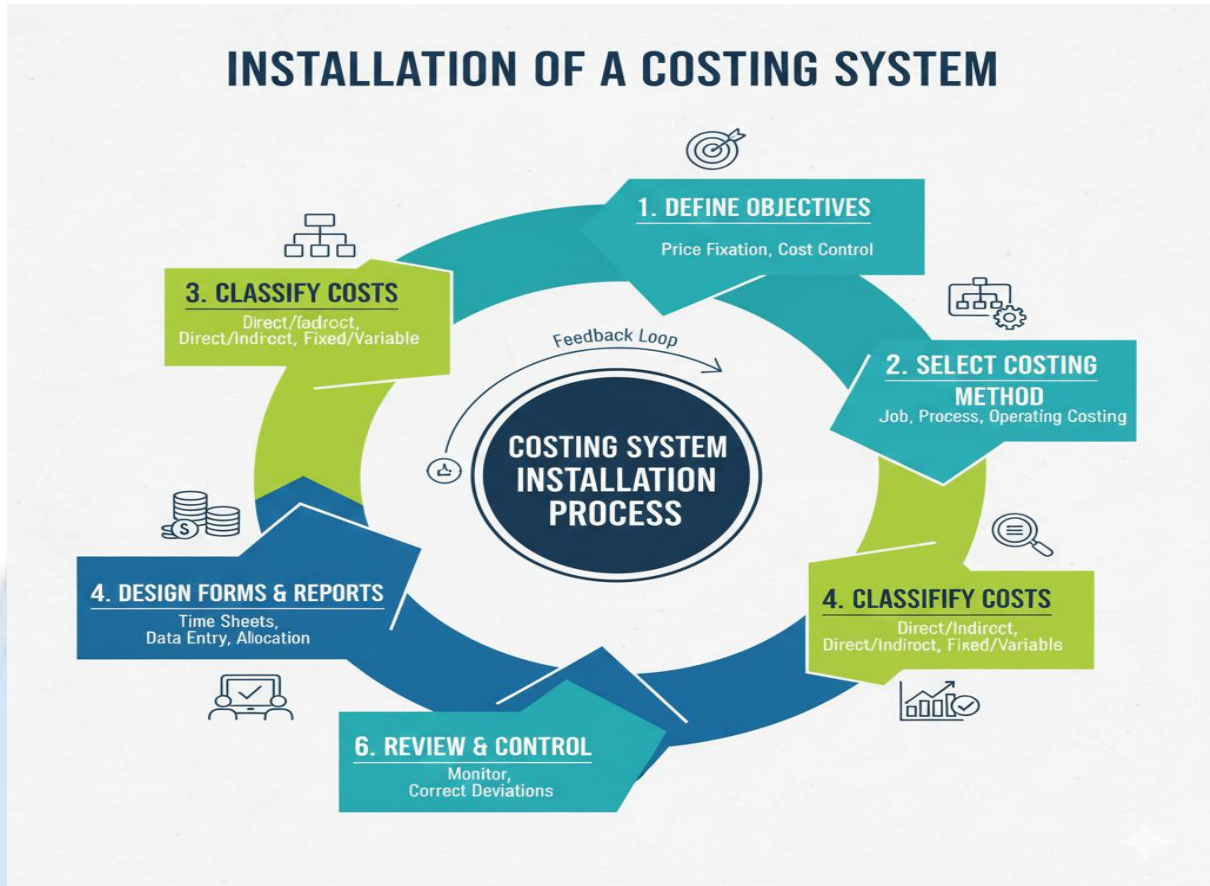
Finally, the cost accounting system should be periodically reviewed to check its effectiveness. Regular review helps identify weaknesses, incorporate improvements, and ensure that the system remains relevant to changing business needs.

## **Steps for Installation of a Cost Accounting System**

A good cost accounting system should be:

1. Simple and flexible
2. Suitable to the nature of business
3. Economical
4. Accurate and reliable
5. Integrated with financial accounting
6. Supported by management
7. Properly documented
8. Periodically reviewed

# INSTALLATION OF A COSTING SYSTEM



## 1. Define objectives clearly

The first and most important step in installing a cost accounting system is to clearly define its objectives. Management must decide what it wants to achieve through the system, such as cost control, cost reduction, price fixation, profit measurement, or decision-making support. Clear objectives ensure that the system is designed in line with the organization's needs and avoids unnecessary complexity.

## 2. Select appropriate costing method

After defining objectives, a suitable costing method should be selected based on the nature of production and business operations. The method chosen may be job costing, batch costing, process costing, or any other relevant method. Selecting the correct method ensures accurate cost determination and effective application of the cost accounting system.

## 3. Classify costs properly

Proper classification of costs is essential for meaningful cost analysis and control. Costs should be classified according to nature, function, behaviour, controllability, and time. Accurate classification helps management identify cost patterns, control expenses, and make informed decisions.

## 4. Design suitable forms and reports

Well-designed forms, records, and reports are necessary for collecting and presenting cost information. These documents should be simple, clear, and standardized to avoid confusion. Effective reporting helps management understand cost data quickly and take timely corrective action.

## 5. Train staff

Employees involved in cost accounting must be properly trained to understand costing procedures

and documentation. Training ensures accurate recording of data, smooth implementation of the system, and reduces errors. Skilled staff also help in effective use of cost information.

6. **Ensure regular review and control**

Once the cost accounting system is implemented, it should be reviewed regularly to ensure its effectiveness. Periodic review helps identify weaknesses, update procedures, and adapt to changes in business conditions. Continuous control ensures that the system remains relevant, accurate, and useful for management.



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**MODULE 2**

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# Definition of Inventory

## Meaning of Inventory

Inventory refers to **stock of goods and materials** held by an organization for the purpose of **production or sale**. It includes raw materials, work-in-progress, and finished goods.

## Definition

Inventory can be defined as **the physical stock of items maintained by a business to ensure smooth production and uninterrupted sales**.

## Materials and Material Control

### Meaning of Materials

Materials are the basic raw inputs used in the production process to manufacture finished goods. They form a major part of the total cost of production in manufacturing industries. Materials include raw materials that are directly converted into finished products, components that are assembled into the final product, and consumable stores such as lubricants, fuel, and small tools that support the production process.

### Meaning of Material Control

Material control refers to the systematic process of planning, purchasing, storing, issuing, and controlling materials used in production. The main purpose of material control is to ensure that the **right quantity of materials is available, at the right time, and at the minimum possible cost**. Effective material control helps avoid overstocking, understocking, wastage, and theft, thereby ensuring smooth production operations and efficient use of resources.

## Objectives of Material Control

### 1. To ensure uninterrupted production

One of the primary objectives of material control is to ensure a continuous and smooth flow of production. By maintaining adequate availability of materials, production stoppages due to shortage of raw materials are avoided, which helps in meeting production schedules and customer demand on time.

### 2. To maintain optimum stock levels

Material control aims to maintain an optimum level of inventory, which means neither excess stock nor shortage. Maintaining optimum stock levels ensures efficient utilization of capital and prevents unnecessary blocking of funds in inventory.

### 3. To reduce material wastage and losses

Effective material control helps in minimizing wastage, spoilage, pilferage, and damage of materials during storage and handling. Proper supervision and control techniques ensure better utilization of materials and reduction in avoidable losses.

### 4. To minimize storage and carrying costs

Storing large quantities of materials involves costs such as rent, insurance, handling, and maintenance. Material control helps in reducing these storage and carrying costs by avoiding excessive stock and ensuring systematic inventory management.

5. **To avoid over-stocking and under-stocking**

Over-stocking leads to increased carrying costs and risk of obsolescence, while under-stocking can disrupt production. Material control ensures a balance between the two by determining proper reorder levels and quantities.

6. **To ensure quality of materials**

Material control ensures that only materials of the required quality are purchased and issued for production. Proper inspection and quality checks help maintain product quality and reduce rejection and rework costs.

7. **To provide accurate material cost data**

An efficient material control system provides accurate and timely information regarding material costs. This data is essential for cost accounting, pricing decisions, budgeting, and overall cost control within the organization.

## **Necessity and Advantages of Material Control**

### **Necessity of Material Control**

Material control is necessary because materials constitute a major portion of the total cost of production, especially in manufacturing industries. Without proper control, material costs can increase unnecessarily and reduce profitability. Poor material control often leads to wastage, spoilage, and theft, which directly increases production costs. Excessive stocking of materials blocks valuable working capital and increases storage and carrying costs. On the other hand, shortage of materials may stop or delay production, leading to loss of sales and customer dissatisfaction. Therefore, an effective material control system is essential to ensure efficient use of materials and smooth production operations.

### **Advantages of Material Control**

Material control results in reduction in material cost by avoiding unnecessary purchases, wastage, and inefficient usage. It ensures a smooth and uninterrupted flow of production by maintaining adequate availability of materials at all times. Effective material control leads to better inventory management by maintaining optimum stock levels and reducing overstocking and understocking. It helps in preventing losses due to wastage, pilferage, damage, and obsolescence. As a result of lower costs and efficient operations, overall profitability of the organization improves. Additionally, material control provides accurate material cost data, which is essential for cost accounting, pricing decisions, and effective managerial control.

## **Purchase Routine**

1. **Meaning of Purchase Routine**

Purchase routine refers to the systematic and standardized steps followed by an organization for procuring materials of the right quality and quantity at the right time and at the best possible price. A well-defined purchase routine ensures smooth production operations and effective material control.

2. **Purchase Requisition**

The purchase process begins with a purchase requisition. It is a formal request sent by the production department or stores department to the purchase department, indicating the need for specific materials. The requisition mentions details such as type of material, quantity required, quality specifications, and delivery time. This step ensures that materials are purchased only when required.

3. **Selection of Supplier**

After receiving the purchase requisition, the purchase department selects a suitable supplier. Supplier

selection is based on factors such as price, quality of materials, reliability, delivery time, credit terms, and past performance. Proper selection helps in obtaining quality materials at reasonable cost.

4. **Purchase Order**

A purchase order is a formal contract issued by the purchase department to the selected supplier. It contains details such as description of materials, quantity, price, delivery date, payment terms, and conditions. The purchase order legally binds both parties and avoids misunderstandings.

5. **Receipt of Materials**

When materials are delivered, they are received by the stores department or receiving department. The quantity received is checked against the delivery note and purchase order. A goods received note is prepared to record the receipt of materials.

6. **Inspection of Materials**

Inspection of materials is carried out to ensure that the materials received are of the required quality and specifications. Defective or substandard materials are rejected and returned to the supplier. Proper inspection helps maintain product quality and reduce production losses.

7. **Passing Purchase Bill for Payment**

After inspection and acceptance of materials, the supplier's invoice is verified with the purchase order and goods received note. Once verified, the bill is passed for payment. This step ensures accurate payment and prevents errors or fraud.

## Stores Routine

1. **Meaning of Stores Routine**

Stores routine deals with the receipt, storage, and issue of materials in an organized manner. It ensures that materials are properly safeguarded and made available to production departments as and when required.

2. **Receiving Materials**

The stores department receives materials from the receiving section after inspection. The received materials are recorded in stores records and stock registers. Proper receiving procedures ensure correct quantity and quality of materials are taken into stores.

3. **Proper Storage**

Materials are stored systematically to prevent damage, deterioration, and loss. Proper storage methods include correct layout, labeling, shelving, and use of bins. Scientific storage helps in easy identification and handling of materials.

4. **Issue of Materials Against Requisition**

Materials are issued to production departments only against authorized material requisition slips. This ensures controlled issue of materials and avoids misuse or excess consumption. Each issue is properly recorded for cost accounting purposes.

5. **Maintaining Bin Cards and Stock Records**

Bin cards are maintained at the storage location to record receipt, issue, and balance of materials. Stock records are maintained in the cost accounting department. These records help in monitoring stock levels and planning future purchases.

6. **Preventing Damage and Theft**

The stores department is responsible for protecting materials from damage, pilferage, and theft. Proper supervision, security measures, and regular stock verification help in minimizing losses and maintaining material safety.

## Control of Inventory

Inventory control refers to the **systematic management of materials and stock** so that the right quantity of inventory is available at the right time, without overstocking or understocking. It is an important part of material control and helps ensure smooth production, cost efficiency, and effective use of working capital.

Effective inventory control aims to maintain **optimum stock levels**. Excess inventory leads to higher storage, insurance, and carrying costs, while insufficient inventory may cause production stoppages and loss of sales. Therefore, inventory control balances availability of materials with cost minimization.

Inventory control helps in **reducing wastage, deterioration, obsolescence, and pilferage** of materials. Through proper planning, storage, and supervision, losses due to damage or expiry of materials can be minimized. Regular stock verification also helps in detecting discrepancies and preventing theft.

Another important aspect of inventory control is **efficient use of working capital**. Inventory represents blocked funds, and excessive investment in stock reduces liquidity. Proper inventory control ensures that capital is not unnecessarily tied up in materials and can be used for other productive purposes.

Inventory control also supports **accurate cost accounting and decision-making**. By maintaining proper records of stock levels, consumption, and value of inventory, management can plan purchases, fix reorder levels, and estimate future material requirements more accurately.

Common techniques of inventory control include **EOQ (Economic Order Quantity), Reorder Level, Minimum and Maximum Levels, ABC Analysis, and Just-in-Time (JIT)**. These techniques help organizations manage inventory efficiently and economically.

### **Economic Order Quantity (EOQ)**

Economic Order Quantity (EOQ) refers to the **ideal quantity of material that should be ordered each time** so that the **total cost of ordering and carrying inventory is minimized**. Ordering cost includes expenses related to placing and processing orders, while carrying cost includes storage, insurance, handling, and risk of obsolescence. EOQ helps management decide the most economical order size that balances these two costs. By using EOQ, firms can avoid both excessive stock and frequent small purchases.

### **Objectives of EOQ**

1. **To minimize inventory cost**

The primary objective of EOQ is to minimize the total inventory cost, which consists of ordering cost and carrying cost. By determining the most economical order size, EOQ ensures that inventory-related expenses are kept at the lowest possible level.

2. **To avoid frequent ordering**

EOQ helps reduce the number of purchase orders by suggesting an optimal quantity to be ordered each time. This saves administrative time, reduces paperwork, and lowers ordering costs associated with frequent purchasing.

3. **To maintain optimum stock**

EOQ assists in maintaining an optimum level of inventory, ensuring that sufficient materials are available for production without overstocking. This balance prevents production interruptions due to shortages and avoids unnecessary investment in excess inventory.

## **Determination of Stock Levels, Inventory Control Systems, and Pricing of Issues of Materials**

### **1. Maximum Stock Level**

Maximum stock level refers to the highest quantity of material that can be stored safely in the store without creating operational or financial difficulties. This level is fixed to prevent over-investment in inventory, excessive storage and carrying costs, and risks such as obsolescence, deterioration, and wastage. Maintaining stock beyond this level unnecessarily blocks working capital and reduces liquidity. Therefore, fixing a maximum stock level helps management keep inventory under control and use resources efficiently.

### **2. Minimum Stock Level**

Minimum stock level is the lowest quantity of material that must be maintained in the store to ensure uninterrupted production. If stock falls below this level, the organization may face shortage of materials and possible stoppage of production. This level acts as a safety margin and protects the firm against delays in supply, sudden increase in consumption, or unexpected demand.

### **3. Re-order Level**

Re-order level is the stock level at which a fresh purchase order is placed for materials. It is fixed in such a way that new materials arrive before the existing stock reaches the minimum level. Proper determination of re-order level ensures continuous availability of materials, avoids emergency purchases, and maintains smooth flow of production without delays.

### **4. Danger Level**

Danger level is a critical stock level that lies below the minimum stock level. When inventory reaches this point, immediate action is required to procure materials, often through urgent or emergency purchases at higher cost. Reaching danger level indicates serious risk of production stoppage and reflects poor inventory planning, which should be avoided through effective control measures.

## **Just-in-Time (JIT) System**

### **Meaning of JIT**

Just-in-Time (JIT) is an inventory management system in which materials are purchased and used exactly at the time they are required in the production process. Under this system, inventory is kept at the lowest possible level, and materials arrive just before their actual use, thereby reducing storage requirements.

### **Advantages of JIT**

The JIT system reduces inventory holding and carrying costs since materials are not stored for long periods. It helps eliminate wastage, damage, and obsolescence of materials due to minimal stock levels. JIT also improves operational efficiency by streamlining production processes and encouraging close coordination between suppliers and production departments.

### **Limitations of JIT**

Despite its benefits, JIT involves a high risk of production stoppage if suppliers fail to deliver materials on time. The system requires highly reliable suppliers, efficient transportation, and strong coordination. Any disruption in supply chain, communication, or logistics can seriously affect production activities.

## **ABC Analysis**

### Meaning of ABC Analysis

ABC analysis is a technique of inventory control that classifies materials into three categories based on their value and importance. Category A consists of high-value items with low quantity, which require strict control and close monitoring. Category B includes items of moderate value that require moderate control. Category C consists of low-value items with large quantity, which require simple control measures.

### Purpose of ABC Analysis

The main purpose of ABC analysis is to focus management attention on the most important and costly inventory items. By concentrating efforts on A-category items, management can achieve effective inventory

Q.1 The following is the receipts and issues of a certain material in factory for quarter ending on 31st March, 2020:

Jan. 20	1	:	Opening Balance 20 kgs at Rs. 2.00
"	4	:	Issued 10 kgs.
Feb.	1	:	Purchased 30 kgs at Rs. 2.50 per kg.
"	6	:	Issued 20 kgs.
"	28	:	Issued 10 kgs.
March	4	:	Purchased 20 kgs at Rs. 3.00 per kg.
"	16	:	Issued 15 kgs.

From the above mentioned information you are required to prepare Stock Register, assuming that issues are priced on FIFO Method and state the value of stock on 31st March, 2020. control with minimum effort, time, and cost, while still maintaining adequate control over other items.

### Methods of Pricing of Issues of Materials

1. Pricing of issues refers to the method used to determine the price at which materials are issued to production or specific jobs. Different methods are adopted depending on price stability, accounting policy, and management requirements.

#### 2. FIFO (First-In, First-Out) Method

Under the FIFO method, materials issued to production are valued at the price of the earliest purchase. This method assumes that materials purchased first are used first. It is simple to understand and easy to apply, and the closing stock reflects current market prices. However, during periods of heavy price fluctuations, issue prices may vary widely, making cost comparison difficult.

Date	Particulars	Receipts (Qty)	Rate (Rs.)	Amount (Rs.)	Issues (Qty)	Rate (Rs.)	Amount (Rs.)	Balance (Qty & Value)
Jan-01	Opening Balance	20 kg	2	40	–	–	–	20 kg @ Rs.2 = 40
Jan-04	Issued	–	–	–	10 kg	2	20	10 kg @ Rs.2 = 20

Feb-01	Purchased	30 kg	2.5	75	–	–	–	10 kg @ Rs.2 = 20
								30 kg @ Rs.2.50 = 75
Feb-06	Issued	–	–	–	10 kg	2	20	–
					10 kg	2.5	25	20 kg @ Rs.2.50 = 50
Feb-28	Issued	–	–	–	10 kg	2.5	25	10 kg @ Rs.2.50 = 25
Mar-04	Purchased	20 kg	3	60	–	–	–	10 kg @ Rs.2.50 = 25
								20 kg @ Rs.3.00 = 60
Mar-16	Issued	–	–	–	10 kg	2.5	25	–
					5 kg	3	15	15 kg @ Rs.3.00 = 45

### Closing Stock on 31st March 2020

Quantity	Rate	Value (Rs.)
15 kg	Rs. 3.00	45

### 3. LIFO (Last-In, First-Out) Method

Under the LIFO method, materials issued are valued at the price of the most recent purchase. This method matches current costs with current revenues, which is useful for profit measurement during inflation. However, the closing stock is valued at older prices and may not represent current market value.

1. The following are the receipts and issues of an item of materials in a factory during August 2020:

August 1	Opening Balance	150 kgs	at Rs. 20
" 3	Issued	50 kgs	—
" 8	Purchases	200 kgs	at Rs. 21
" 16	Issued	150 kgs	—
" 18	Returns from job (out of materials issued on 3rd)	10 kgs	—
" 21	Purchases	300 kgs	at Rs. 19

" 27 Issued 100 kgs —

The report of the stock verifier revealed that there was a shortage of 5 kgs on 31st August.  
Prepare the Stock Register under:

1. LIFO Method

Date	Particulars	Receipts (Qty)	Rate (Rs.)	Amount (Rs.)	Issues (Qty)	Rate (Rs.)	Amount (Rs.)	Balance
Aug-01	Opening Balance	150 kg	20	3,000	—	—	—	150 kg @ 20 = 3,000
Aug-03	Issued	—	—	—	50 kg	20	1,000	100 kg @ 20 = 2,000
Aug-08	Purchased	200 kg	21	4,200	—	—	—	100 kg @ 20 = 2,000 200 kg @ 21 = 4,200
Aug-16	Issued	—	—	—	150 kg	21	3,150	50 kg @ 21 = 1,050 100 kg @ 20 = 2,000
Aug-18	Returns from Job	10 kg	20	200	—	—	—	50 kg @ 21 = 1,050 110 kg @ 20 = 2,200
Aug-21	Purchased	300 kg	19	5,700	—	—	—	300 kg @ 19 = 5,700 50 kg @ 21 = 1,050 110 kg @ 20 = 2,200

Aug-27	Issued	–	–	–	100 kg	19	1,900	200 kg @ 19 = 3,800
								50 kg @ 21 = 1,050
								110 kg @ 20 = 2,200
Aug-31	Shortage (Abnormal Loss)	–	–	–	5 kg	19	95	195 kg @ 19 = 3,705
								50 kg @ 21 = 1,050
								110 kg @ 20 = 2,200

Closing Stock on 31st August 2020		
Quantity	Rate	Value (Rs.)
195 kg	19	3,705
50 kg	21	1,050
110 kg	20	2,200
<b>Total Closing Stock</b>		<b>6,955</b>

#### 4. Base Stock Price Method

Under this method, a minimum quantity of material known as base stock is always maintained in the store and valued at a fixed price. Any quantity issued above the base stock is priced using FIFO or LIFO method. The method is simple and ensures availability of minimum stock, but it is not suitable when prices fluctuate heavily.

#### 5. Weighted Average Price Method

Under the weighted average price method, the issue price is calculated by dividing the total cost of materials in stock by the total quantity available. This method smoothens price fluctuations and provides fair valuation of materials issued. However, it requires calculations after every receipt, which may be time-consuming.

#### 6. Periodic Weighted Average Price Method

In this method, the average price is calculated periodically, such as weekly or monthly, instead of

after every receipt of materials. It reduces calculation work and provides a stable issue price for the period, though it may not immediately reflect recent price changes.

7. **Standard Price Method**

Under the standard price method, materials are issued at a pre-determined standard price. Any difference between the standard price and actual purchase price is treated as a variance. This method is useful for cost control and variance analysis, but standards need frequent revision to remain realistic.

8. **Replacement Price Method**

Under the replacement price method, materials are issued at the current market price at the time of issue. This method reflects the true current cost of replacing materials and is useful for managerial decision-making. However, it ignores the actual purchase price and may cause differences between issue values and inventory records.





**MODULE 3**

विद्या अनन्तम्

**Labour:** Labour is a human resources and effort to convert materials into finished goods. Labour can be divided as direct labour and indirect labour.

**Direct Labour:** Direct labour is that labour which is directly engaged in the production of goods or services and which can be conveniently allocated to the job, process or unit. According to ICMA, "Direct Labour cost is that cost which can be identified with and allocated to cost centres or cost units." For example, labour engaged in making the bricks, carpenter for making furniture etc.

**Feature of direct labour:**

1. Direct labour is apart of prime cost;
2. It can be attributed to finished goods;
3. Its cost can be identified with total cost of production;
4. It varies with change in output;
5. It can be controlled.

**Indirect Labour:** Indirect labour is that labour which is not directly engaged in the production of goods and services but which indirectly helps the direct labour engaged in production. ICMA defines indirect labour cost as "cost other than direct wages cost. For example, mechanics, supervisors, chowkidars, watchmen, sweepers, foremen etc.

**Features of indirect labour:**

1. It is as important as direct labour;
2. Its cost cannot be allocated but can only be apportioned;
3. It cannot be identified with the finished product;
4. It does not vary with the change in production;
5. It cannot be controlled; Its cost is treated as overheads.

**Differences between direct labour and indirect labour:**

**Labour Cost:**

Labour cost is a second major element of cost. Research has shown that in majority cases labour cost constitute about 40% to 50% of total cost of production. It includes monetary benefits like basic wage, DA; deferred monetary benefits like pension, gratuity; non-monetary benefits ( fringe benefits) like canteen, housing; etc.

**Components/elements of Labour Cost:**

Labour costs represent the various items of expenditure incurred on workers by the employer and would include the following:

### **Control of Labour costs:**

Control of labour cost is not as easy as that materials cost. The human element in labour makes difficult the control of labour. Labour Laws in India are such that one can't dispense with the labour even if not need it for some reason. Moreover, it is a perishable commodity and can't be stored like materials. Labour, once lost, cannot be recouped and is bound to increase the cost of production.

The main aim of the control over cost is to keep labour cost per unit of output as low as possible. Labour costs can be controlled by proper employment and thereafter efficient utilization of labour force. Inefficiency of labour is also a cause of excessive materials and overhead costs. There are a number of departments in big industries which influence labour cost. The coordinated efforts of all such departments will be needed to control labour cost. These departments are:

1. Personnel Department,
2. Engineering Department,
3. Time & Motion study Department,
4. Time Keeping Department,
5. Payroll Department &
6. Cost Accounting Department.

**1. Personnel Department:** Personnel department is concerned with employment, transfer and discharge of employees. The department is headed by a responsible officer called Personnel Manager. The important duties of this department include recruitment, selection, training, placement, fixation of remuneration, performance appraisal. Different departments send their requisitions for placement of workers to personnel department and the department decides on the selection procedure to be followed. The department also keeps records of particulars of employees. The record is kept on a card known as Employee History Card.

Functions of this department are as follows:

- (i) Recruitment and selection of workers.
- (ii) Training and development of workers.
- (iii) Orientation and placement of workers.
- (iv) Maintenance of personnel records.

**Time Study:** It may be defined as the observing time required to do a particular job. It relates to fixing the standard time for doing a job under given condition. It is a means to achieve economy in time.

**Motion Study:** It is the study of the movement of an operator or a machine. It aims at eliminating unnecessary, ill-directed and inefficient motions of an employee or machine.

**Distinction between Time Study and Motion Study:**

Basis	Time Study	Motion Study
1. Meaning	It is a technique which is used to measure the time taken by a worker to perform a job.	It is the technique which involved close observation of the movement of the body and limb to perform a job.
2. Purpose	Its purpose is to determine time normally required to perform a job and a fair day's work.	Its purpose is to eliminate wasteful motions and determine the best way of doing a job.
3. Tools of study	It is conducted with the help of stopwatch.	It is conducted with the help of a movie camera.
4. Introducer	It was introduced by F.W. Taylor.	It was introduced by F.B. Gilbreth.

**Labour Turnover:**

The change in the labour force is known as labour turnover. Thus, labour turnover refers to mobility of employees from factory to factory for getting better opportunities in terms of earning and position. It denotes the percentage changes in the labour force of an organisation.

Normal labour turnover is advantageous as it allows injection of fresh blood into the firm. But excessive turnover is not desirable because it increases cost of labour. This is because efficient and experienced workers leave the factory and new employees come and occupy their places. Naturally, the ability of such new workers is less as compared to that of the experienced workers. The desirable percentage of labour turnover is placed between 3 percent and 5 percent.

**Methods of measurement of Labour turnover:**

Sometimes, flux rate can be calculated in the following way, when there is recruitment for expansion:

No. of separation + No. of accession

Flux rate = ----- x 100

Average no. of employees during the year

Where,

No. of Accession = No. of replacement + No. of new employment for expansion.

## **SPECIAL ITEMS IN LABOUR COST CONTROL:**

### **1. IDLE TIME:**

Idle time is that time for which payment made but no direct production/ benefit is obtained by the employer. Hence, there is no production during idle time. The question of the idle time arises only when the payment is made on time basis. The difference between time booked and factory gate time is known as idle time. Therefore is calculated in the following way:

Idle Time = Time keeping as per Time Card – Time booking as per Job Card.

Idle time is of two types:

(a) Normal Idle Time: Normal idle time is that time the wastage of which cannot be avoided; therefore the employer will have to bear the labour cost for this time. Reasons for normal idle time:

- (i) Time taken by the workers from the factory gate to reach the spot of production.
- (ii) Time lag between two consecutive works. (for finishing one & starting the next.)
- (iii) Breaks allowed during the working hours. Such as tea, lunch break.
- (iv) Interruption of machineries.
- (v) Waiting for job, work etc,

(b) Abnormal Idle Time: It is that time the wastage of which can be avoided by taking proper precautions.

Reasons:

- (i) Breakdown of machineries,
- (ii) Power failure,
- (iii) Shortage of materials,
- (iv) Unnecessary waiting for instruction, materials, tools etc.
- (v) Strikes & lock outs.

### **Causes of Idle Time:**

- (a) Production causes:
- (b) Machine breakdown,
- (c) Power failures,
- (d) Waiting for work,
- (e) Waiting for tools,
- (f) Waiting for materials,
- (g) Waiting for instruction.
- (h) Administrative causes: (due administrative decision):
  - (i) No reduction in labour force during depression,
  - (ii) Under utilization of capacity of plants.
- (i) Economic causes:

- (i) Seasonality of products,
- (ii) Non-availability of materials,
- (iii) Lack of demand,
- (iv) Period of depression.

**Accounting treatment of Idle Time Cost in Cost Accounts:**

1. Cost of normal idle time which is uncontrollable is treated as Direct Labour Cost for each job.
2. Cost of normal idle time which can be controlled is treated as Production Overheads.
3. Cost of abnormal idle time is not treated as part of cost and hence charged to Costing Profit and Loss Account.

**Control of Idle Time Cost:**

To exercise an effective control over idle time, the following steps are suggested:

1. Step: Fix the standards for normal idle times such as tea break, lunch break,
2. Step: Prepare Periodic Idle Time Report by showing reasons and cost to the management.
3. Step: Compare the actual idle time with standard idle time to find out the variance.
4. Step: Investigate the variance.
5. Step: Take the necessary corrective action promptly.

**2. OVERTIME:**

Overtime is an extra time over and above the normal working hours. According to the Factories Act, 1949, a worker is entitled to overtime wages when he works for more than 9 hours on a day and more than 48 hours in a week. In India, overtime is to be paid at double the normal rate of wages. The additional amount paid on account of overtime is known as overtime premium.

Overtime premium = Overtime Hours x Overtime Wage Rate.

**Effects of Overtime premium on productivity:**

There are adverse effects of overtime on the productivity of the worker and on the cost of the production due to the following reasons:

- (i) Overtime is paid at a higher/double rate;
- (ii) Efficiency of the workers reduced in overtime work comparing to normal time;
- (iii) Worker will adopt the habit of postponing the work to be done in overtime just to earn more wages, hence, fall in output during normal time;
- (iv) Regular overtime working has an adverse effect on the health of workers;
- (v) Expenses like lighting, cost of supervision, wear and tear on machinery etc. will increase disproportionately;

(vi) It may lead to discontent (dissatisfaction) among workers if overtime is not distributed properly. Therefore, overtime work should be avoided because jobs done in overtime cost more compared to the job done during normal hours. However, overtime cannot be totally eliminated because there are some genuine reasons when there is no other alternative but to do overtime work.

**Circumstances under which overtime may arise/Causes of overtime: And, Accounting treatment of overtime premium:**

<b>Circumstances/Causes</b>	<b>Treatment of overtime premium</b>
<b>1. When it is desired at customer's request to complete the work within specified time.</b>	<i>It should be charged directly to the job as Direct Labour Cost.</i>
<b>2. When it is required to increase the output as per general production programme.</b>	<i>It should be treated as Production Overheads.</i>
<b>3. When it is required to meet seasonal demand.</b>	<i>It should be treated as Production Overheads.</i>
<b>4. When it is required to increase the output to meet the additional market demand</b>	<i>It should be treated as Production Overheads.</i>
<b>5. When it is required to make up any short fall in production due to additional conditions such as flood, earthquake, breakdown of machinery etc.</b>	<i>It should not be treated as part of cost and hence charged to Costing Profit and Loss Account.</i>

**Control over Overtime Work:**

Keeping in view the disadvantages of overtime work, it is necessary that proper control should be exercised in order to keep it minimum possible level. The following steps are to be taken in this regard:

1. A proper control should be exercised during normal hours to ensure that overtime is not allowed when normal output is not achieved during normal working hours.
2. A statement of overtime should be prepared by showing why, where and how much overtime is required.
3. Fix an upper limit of overtime for each category of workers.
4. Do not allow any overtime without prior sanction from competent authorities.
5. Compare the actual rate of output produced during the overtime period with the normal rate of output.
6. Periodical report on overtime along with wages sheet should be submitted to the top management.

**3. LEAVE WITH PAY:**

Leave days with pay constitute unproductive working days. According to the Factories Act, workers are entitled to annual leave with full pay for specified number of days in a year. This may include casual leave, medical leave, special leave, etc. The cost of paid leave cannot be charged to any work order or cost unit, since no work is done during this period. It is, therefore, treated as indirect labour cost and charged to overheads.

Alternatively, leave wages may be treated as direct labour cost when the wage rate is inflated (overstated). This is done by estimating in advance the amount of leave wages and spreading it over the actual number of working hours to give it an inflated hourly rate.

#### **4. ABSENTEEISM:**

#### **METHODS OF WAGES PAYMENTS:**

The two principal methods of wages payments are as follows:

1. Time Rate Wage System, and
2. Piece Rate Wage System.

**1. Time Rate Wage System:** Under this system wages are paid on the basis of time worked by the workers. There are different types of time rate wage system, few of them are:

(i) Flat time rate: It is the oldest method of wage payment. Under this system, workers are paid at a flat rate on the basis of time they are worked.

Earning/wages = Actual time worked × Time rate

(ii) High day rate: High rate is given to attract the efficient workers who can easily be motivated to achieve predetermined standards of efficiency which is relatively high.

(iii) Graduated time rate: Under this method wages are based on cost of living index of the workers.

#### **Advantages of Time Rate Wage System:**

1. It is easy to understand and simple to operate.
2. It provides guaranteed time wages to workers.
3. Worker can concentrate on the quality rather than the quantity.
4. There is less damage and wages of materials and tools.

#### **Disadvantages of Time Rate Wage System:**

1. It does not act as an incentive to workers.
2. It tends to increase overheads and labour cost due to low production.
3. There develops a tendency to go slow during normal working hours in the hope of getting more wages by overtime.
4. High degree of supervision is required.

**2. Piece Rate Wage System:** Under this system wages are paid on the basis of the number of articles produced by the workers. Piece rate system can be of the following types:

(i) Straight piece rate: Under this system, each unit produced is taken as a piece. A piece rate is fixed for a unit of product produced. It can be calculated in the following way:

Earning = No. of piece produced  $\times$  Piece rate.

(ii) Piece rate with guaranteed wages: Piece rate with guaranteed wages is applicable for the new and in efficient workers. They earn meagre salary instead of paying normal piece rate and this encourages the workers to improve their efficiency gradually and there afterwards reach the standard of other workers.

(iii) Differential piece rate system: Under this system, the wages of workers vary at different stages, within a certain range of output. The two system which work under this principle are:

- (a) Taylor's differential piece rate system, and
- (b) Merrick's differential piece rate system.

(a) **Taylor's differential piece rate system**: This system was designed by F.W. Taylor in 1880. The features of this system of wage payment are as follows:

- (i) There is no guaranteed wages.
- (ii) Standard time is fixed for each work.
- (iii) Two differential piece rates are fixed: '**Lower piece rate**' i.e. 80% of the normal piece rate for the workers produce below the standard out. '**Higher piece rate**' i.e. 120% of the normal piece rate for the workers produce standard output or more than standard output. (Some authors use 83% and 125% for lower and higher piece rates respectively.)

(b) Merrick's differential piece rate system: This method is also known as 'Multiple piece rate system'. Under this method, three grade piece rates are used instead of two as in the case of Taylor's. The features are as follows:

- (i) There is no guaranteed wages.
- (ii) Standard time is fixed for each work.
- (iii) Slabs are:

Upto 83 1/3% of the standard output - 100% of ordinary piece rate.

Above 83 1/3% and upto 100% of the standard output - 110% of ordinary piece rate. Above 100% of the standard output - 120% of ordinary piece rate.

#### **Advantages of piece rate wages system:**

1. It is easy to understand and simple to operate.
2. It acts as an incentive to workers to produce more to earn more.
3. It tends to reduce overhead cost and labour cost per unit.
4. It eliminates the tendency of workers to go slow as remuneration is directly linked with performance.
5. Low degree of supervision is required.

#### **Disadvantages of piece rate wages system:**

1. It does not guarantee time wage to workers and hence workers feel insecure.
2. Workers tend to increase the quantity ignoring the quality of the products.
3. There may be excessive wastage and damage of materials and machine, tools.
4. The calculation of piece rate is more difficult than time rate.
5. It is usually opposed by trade union and workers.

**Distinction between Time rate wages system and Piece rate wages system:**

<b>Time rate wage system</b>	<b>Piece rate wages system</b>
<b>1. Basis of payment:</b> Workers are paid at a fixed rate per hour, per day or per month for the time devoted by them.	Workers are paid at a fixed rate per unit produced or job completed.
<b>2. Performance and reward:</b> There is no linkage between performance and reward.	The linkage between performance and reward motivates the worker to produce more.
<b>3. Quality:</b> Quality of work tends to be high.	Quality of work tends to be low.
<b>4. Wastage &amp; Damage:</b> There are less chances of wastage of materials and damage of machinery, tools, equipments etc.	There are more chances of wastage of materials and damage of machinery, tools, equipments etc.
<b>5. Supervision:</b> Close supervision is required.	Close supervision is not required.
<b>6. Maintenance:</b> Cost of maintenance is low.	Cost of maintenance is high.
<b>7. Attitude of Trade Union:</b> Trade Unions prefer it.	Trade Unions oppose it.

7. It should provide for **prompt payment of incentives** at short intervals of time.

8. It should have **approval** of workers and trade union.

9. It should **discourage the workers** to increase spoiled work.

10. It should be **flexible** enough so as to introduce the necessary changes, if any required.

**IMPORTANT TYPES OF INCENTIVE SYSTEM:**

**1. Halsey Premium Plan:** This system was introduced by F.A. Halsey, an engineer of America in 1891. The main features of this system are as follows:

- (i) Standard time is fixed for each work.
- (ii) It guarantees the hourly wage to workers for the actual time taken.
- (iii) Bonus is paid if the time is saved.
- (iv) Bonus is equal to 50% of the time wages of time saved.

**2. Rowan Plan:** This incentive system was introduced by James Rowan of Scotland. Under this system bonus is also paid on the time saved.

## Practical Sums

### Problem No.1

Calculate the earnings of a worker from the following information:

- a) Time Rate Method, b) Piece Rate Method, c) Halsey Plan and d) Rowan Plan

Information given:

Standard Time – 30 hours

Time taken – 20 hours

Hourly rate of wages is Re.1 per hour plus a dearness allowance @ 50 paise per hour worked.

Solution :

a) Earnings under Time Rate Method

Wages for 20 hours (time taken) @ Re.1 per hour Rs.20

Dearness allowance for 20 hours @ 50 paise per hour Rs.10

Rs.30

=====

b) Earnings under Piece Rate Method

Wages for 30 hours (time allowed) @ Re.1 per hour Rs.30

Dearness allowance for 20 hours (i.e., actual hours worked) Rs.10

Rs.40

=====

c) Earnings under Halsey Plan

Wages for 20 hours (i.e., actual hours worked)

@ Re.1 per hour Rs.20

Bonus for the half of the time saved  $[1/2 \times (S-T) \times R]$  Rs.5

Dearness allowance for 20 hours (i.e., actual hours worked) Rs.10

Rs.35

=====

d) Earnings under Rowan Plan

Wages for 20 hours (i.e., actual hours worked)

@ Re.1 per hour Rs.20.00

Bonus  $[(S-T)/S \times T \times R]$  Rs.6.67

Dearness allowance for 20 hours (i.e., actual hours worked) Rs.10.00

Rs.36.67

=====

Where S = Standard Time Allowed; T = Actual Time taken; R = Rate per hour

## Problem No.2

Calculate the normal and overtime wages payable to a workman from the following data:

Days	Hours worked	Rate
Monday	8 hours	Normal working hours
Tuesday	10 "	
Wednesday	11 "	Normal Rate
Thursday	12 "	Overtime Rate
Friday	8 "	
Saturday	4 "	
	53 hours	

Rs. 5.00 per hour  
Up to 9 hours in a day at single rate and beyond 9 hours in a day at double rate.

### Solution

Day	Normal working hours	Total	Overtime		
			At Normal rate	Single rate	Double rate
Monday	8	8	8	-	-
Tuesday	8	10	8	1	1
Wednesday	8	11	8	1	2
Thursday	8	12	8	1	3
Friday	8	8	8	-	-
Saturday	8	4	4	-	-
	48	53	44	3	6

Normal wage on time rate	=	44 hours × 5	=	Rs. 220.00
Overtime wages - Single rate	=	3 hours × Rs. 5	=	Rs. 15.00
Double rate	=	6 hours × Rs. 10	=	Rs. 60.00
Total wages	=		=	Rs. 295.00

## Problem No.3

From the following particulars calculate the wages of 3 workers Amar, Akbar and Anthony under Merrick's Differential Piece Rate. Piece Rate is 40 paise per unit, standard output 30 units per day of 8 hours. Outputs: Amar - 24 units, Akbar - 27 units and Anthony - 36 units.

Solution:

Efficiency of each worker as a percentage of standards:

$$\text{Amar} = \frac{24}{30} \times 100 = 80\% \quad = \text{below } 83\%$$

$$\text{Akbar} = \frac{27}{30} \times 100 = 90\% \quad = \text{above } 83\% \text{ but below } 100\%$$

$$\text{Anthony} = \frac{36}{30} \times 100 = 120\% \quad = \text{above } 100\%$$

**Calculation of Wages**

1. Amar =  $24 \times 0.40 = \text{Rs. } 9.60$
2. Akbar = 110% of normal wage rate  
i.e.  $\frac{110}{100} \times \text{Rs. } 0.40 \times 27 \text{ units} = \text{Rs. } 11.88$
3. Anthony = 120% of normal piece rate =  $\frac{120}{100} \times 0.40 \times 36 = \text{Rs. } 17.28.$

**Problem No.4:**

R Limited operates in one of its departments a group incentive scheme. A minimum hourly rate is guaranteed to each of the six employees in the group if actual output for the week is less than the standard output. If actual output 0.50 greater than the standard output, the hourly rate of each employee is increased by 4% for each additional 600 units of output produced.

The standard output for the group is 12,000 units for a 40 hour week.

During the week ended December 31, 2019 each employee in the group worked 40 hours; actual output and minimum hourly rates were as follows :

<i>Employee</i>	<i>Actual output (in units)</i>	<i>Minimum hourly rate</i>
Lal	2,500	0.60
Hari	2,700	1.00
Mohan	2,400	0.60
Shyam	2,500	0.80
Hanuman	2,460	0.60
Krishna	2,440	0.40

**You are required to:**

- (i) Calculate the earnings of each employee.
- (ii) Appraise the effectiveness to the company of this group incentive scheme.

**Solution:**

Statements showing the earning of each employee in the group during the week ending 31st December, 2019:

Employee	Minimum	Hourly premium	Total	Total wages for the week
	Re.	Re.	Re.	Rs.
Lal	0.60	0.12	$0.72 \times 40 =$	28.80
Hari	1.00	0.20	$1.20 \times 40 =$	48.00
Mohan	0.60	0.12	$0.72 \times 40 =$	28.80
Shyam	0.80	0.16	$0.96 \times 40 =$	38.40
Hanuman	0.60	0.12	$0.72 \times 40 =$	28.80
Krishna	0.40	0.08	$0.48 \times 40 =$	19.20
				<u>192.00</u>

**Working Notes :**

1. Calculation of percentage increase in the hourly wage rate due to higher efficiency :

	Output (40 hrs. week)
Standard	12,000 units
Actual	15,000 units
Additional production	3,000 units

Increase in wage rate is 4% for each additional 600 units.

$$\text{Therefore, total increase} = \frac{3,000 \times 4}{600} = 20\%$$

2. There is a saving of Rs. 8 (Standard Wages Rs. 200–Actual Wage Rs. 192). This saving has been shared both by the employer and employee.
3. Standard wages =  $\frac{160 \times 15,000}{12,000} = \text{Rs. } 200.$

**Problem No.5**

Calculate total monthly remuneration of workers A, B, C and D on the basis of the following information for the month of January 2007:

- (i) Standard Production for each worker = 1,000 units
- (ii) Rate of wages = 10 paise per unit
- (iii) Bonus = Rs. 5 for each 1% increase over 90% of the standard.
- (iv) Dearness Allowance per month = 100% of piece wage.

The units completed by the four workers were as under:

A =950 units, B=900 units, C = 960 units, D =850units.

**Solution:**

**%of workdonebytheworkers:**

$A = 950/1,000 \times 100 = 95\%$

$B = 900/1,000 \times 100 = 90\%$

$C = 960/1,000 \times 100 = 96\%$

$D = 850/1,000 \times 100 = 85\%$

**Statement showing Calculation of Remuneration**  
for the month of January 2007

<i>Particulars</i>	<i>A Rs.</i>	<i>B Rs.</i>	<i>C Rs.</i>	<i>D Rs.</i>
Piece wages [Units produced × Rate per unit]	95	90	96	85
D.A. [100% of piece wages]	95	90	96	85
Bonus [Rs. 5 for each 1% increase over 90% of the standard]	25	—	30	—
<b>Total Earnings</b>	<b>215</b>	<b>180</b>	<b>222</b>	<b>170</b>

**Problem No.6**

In a factory bonus system, bonus hours are credited to the employee in the production of time taken which times saved bear to time allowed. Jobs carried forward from one week to another. No overtime is worked and payment is made in full for all units worked on, including those subsequently rejected.

**From the following, you are required to calculate for each employee:**

- (a) The bonus hours and amount of bonus earned;
- (b) Total wage cost;
- (c) The wage cost of each good unit produced.

Name of employees	A	B	C
Basic wage rate per hour	Rs. 5	Rs. 8	Rs. 10
Units issued for production	2,500	2,200	3,600
Time allowed for 100 units	2 hrs	3 hrs	4 hrs
Time Taken	40 hrs	60 hrs	140 hrs
Rejects	100 units	50 units	100 units

Solution:

(a) **Statement of Calculation of Bonus**

Name of the Employees	A	B	C
Time taken	40 hrs	60 hrs	140 hrs
Time allowed [Time allowed × Units produced]	50 hrs	66 hrs	144 hrs
Time saved [Time allowed – Time taken]	10 hrs	6 hrs	4 hrs
∴ Bonus $\left[ \text{Time saved} \times \frac{\text{Time taken}}{\text{Time allowed}} \times \text{Rate} \right]$	Rs. 40	Rs. 43.64	Rs. 38.89

(b) **Statement of Calculation of Units of Goods Produced by A, B and C**

Name of the Employees	A units	B units	C units
Production	2,500	2,200	3,600
Rejection	100	50	100
Production of goods units [Production – Rejection]	2,400	2,150	3,500

(c) **Statement of Calculation of Earnings of A, B and C**

Name of the Employees	A (Rs.)	B (Rs.)	C (Rs.)
Basic Wages [Time taken × Rate per hour]	200	480	1,400
Bonus	40	43.64	38.89
Total Earnings [Wages + Bonus]	240	523.64	1,438.89
Wage Rate per unit of goods output $\left[ \frac{\text{Time Earnings}}{\text{No. of goods units}} \right]$	0.10	0.24	0.41

**Problemsno.7**

ABC Ltd. is having 400 workers at the beginning of the year and 500 workers at the end of the year. During the year 20 workers were discharged and 15 workers left the organization. During the year the company has recruited 65 workers. Of these, 18 workers were recruited in the vacancies of those leaving, while the rest were engaged for an expansion scheme. What is the labour turnover rate under separation method ?

Solution:

Average number of workers =  $(400 + 500)/2 = 450$  Separation method = No. of separations during the period x 100 Average number of workers during the period =  $20 + 15 \times 100 / 450 = 7.78\%$

### Problem No.8

'Under the Rowan Premium Bonus system, a less efficient worker can obtain same bonus as a highly efficient worker.' Discuss with suitable examples.

#### Solution

Bonus under Rowan system =  $(\text{Time allowed} / \text{Time taken}) \times \text{time saved} \times \text{rate per hour}$  For example let time allowed for a job = 4 hours and Labour rate = Rs. 5 per hour.

#### Case I : Less efficient worker

If time taken = 3 hours

Then time saved =  $4 - 3 = 1$  hour

Bonus =  $(3 \text{ hours} / 4 \text{ hours}) \times 1 \text{ hour} \times \text{Rs. } 5 = \text{Rs. } 3.75$

#### Case II : Highly efficient worker

If time taken = 1 hour

Then time saved =  $4 - 1 = 3$  hours

Bonus =  $(1 \text{ hour} / 4 \text{ hours}) \times 3 \text{ hours} \times \text{Rs. } 5 = \text{Rs. } 3.75$

So, it can be concluded that under Rowan System, the less efficient worker and highly efficient worker can get the same bonus.

### Problem No.8

Discuss the treatment of overtime premium in cost accounts.

#### Solution

Overtime premium is a part of total wages of overtime period. In cost accounting the treatment of overtime premium will be as follows:

- (i) If the overtime is resorted to at the desire of the customer, then the entire amount of overtime including overtime premium should be charged to the job directly.
- (ii) If it is due to a general pressure of work to increase the output, the premium as well as overtime wages may be charged to general overheads.
- (iii) If it is due to the negligence or delay of workers of a particular department, it may be charged to the concerned department.
- (iv) If it is due to circumstances beyond control, it may be charged to Costing Profit & Loss Account.

### Problem No.9

In a unit, 10 men work as a group. When the production for the group exceeds the standard output of 200 pieces per hour, each man is paid an incentive for the excess production in addition to his wages at hourly rates. The incentive is a half the percentage, the excess production over

the standard bears to the standard production, Each man is paid an incentive at the rate of this percentage of a wage rate of `2 per hour. There is no relation between the individual workman's hourly rate and the bonus rate.

In a week, the hours worked are 500 hours and the total production is 1,20,000 pieces.

(a) Compute the total amount of the bonus for the week.

(b) Calculate the total earnings of two workers A and B of the group:-

A worked 44 hours and his basic rate per hour was Rs. 2.20.

B worked 48 hours and his basic rate per hour was Rs. 1.90.

### Solution

Actual production during the week	1,20,000 pieces
Standard production during the week of 500 hours, @ 200 pieces per hour	1,00,000 pieces
Excess production over standard	20,000 pieces
Percentage of the excess production over the Standard bear to the standard production	$= (20,000 / 1,00,000) \times 100 = 20\%$

Incentive is half of 20% i.e. 10%.

The rate of incentive is at 10% over a wage rate of Rs. 2.00 per hour. Thus the rate of incentive per hour is 0.20P.

(a) Total amount of bonus for the week: 500 hours  $\times$  Re. 0.20 = Rs. 100.

(b) Total Earnings of two workers A & B of the group.

Amount

Rs.

A's Wages for 44 hours @ Rs. 2.20 per hour	96.80
Bonus for 44 hours @ Re. 0.20 per hour	8.80
Total Earning of A	105.60
B's Wages for 48 hours @ Rs. 1.90 per hour	91.20
Bonus for 48 hours @ 0.20 per hour	9.60
Total Earning of B	100.80

### Problem No.10

(c) The cost accountant of Y Ltd. has computed labour turnover rates for the quarter ended 31st March, 2019 as 10%, 5% and 3% respectively under Flux method, 'Replacement method' and 'Separation method'. If the number of workers replaced during that quarter is 30, find out the number of (1) workers recruited and joined and (2) workers left and discharged.

### Solution

#### Working Note:

Average number of workers on roll:

Labour turnover rate (under Replacement method)

$$= (\text{No. of replacements} / \text{Average number of workers on roll}) \times 100 \text{ Or } 5/100 =$$

$30 / \text{Average number of workers on roll}$

$$\text{Average number of workers on roll} = (30 \times 100) / 5 = 600$$

(1) Number of workers recruited and joined:

Labour turnover rate (Flux method) =

$$= [\text{No. of separations (S)} + \text{No. of accessions (A)}] / \text{Av. number of workers on roll} \times 100 \text{ (Refer to Working Note)}$$

$$\text{Or } 10/100 = (18 + A) / 600$$

$$\text{Or } A = [(6000/100) - 18] = 42$$

No. of workers recruited and joined 42.

(2) Number of workers left and discharged:

Labour turnover rate (Separation method)

$$= \text{No. of separations (S)} / \text{Av. number of workers on roll} \times 100 \text{ (Refer to working note)}$$

$$\text{Or, } 3/100 = S / 600 \text{ Or, } S = 18$$

Hence, number of workers left and discharged comes to 18.





**MODULE 4**

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The third important element of costs of any product or service is overheads. Overheads may be manufacturing or non-manufacturing. Later we briefly discuss the classification of overheads. Before that let us see what are overheads? Defining **overheads** particularly focuses on the concept of direct and indirect expenses which in turn depends on the traceability of the expenses with the product or service. In other words, expenses that cannot be directly traceable to any product or service are known as overheads. Simply, overheads are sum of all indirect expenses i.e.

$$\text{Overheads} = \text{Indirect materials} + \text{Indirect labour} + \text{Indirect expenses}$$

**Classification of overheads:** In general, overheads may be classified as

<b>Overheads</b>		
Elementwise	Functionwise	Behaviourwise
a) Indirect material	a) Factory Overhead	a) Variable overhead
b) Indirect labour	b) Office & Administrative Overhead	b) Fixed overhead
c) Indirect expenses	c) Selling & Distribution Overhead	c) Semi-variable overhead

Of the above classification functional and behavioural classification are included in the syllabus.

**Functional classification-** Functionally, overheads are classified into Factory overheads, Office and Administrative overheads, and Selling and Distribution overheads. Factory overhead is actually manufacturing overhead while the other two are non-manufacturing overhead. Factory rent and taxes, indirect wages, are examples of factory overhead while, salary of office staff is an example of office and administrative overhead, and commission of salesman is an example of selling and distribution overhead.

**Behavioural Classification-** On the basis of behaviour, overheads can be classified as variable overhead, fixed overhead and semi-variable overhead.

**Variable overheads-** are those overheads that vary in direct proportion with the level of activity. For example, indirect wages, salesman's commission etc.

**Fixed Overheads-** are those overheads that remain fixed irrespective of the level of activity within a relevant range. For example, factory rent.

**Semi-variable Overhead-** are those overheads that vary with the level of activity but not in direct proportion. Examples are repair and maintenance, electricity charges etc.

We shall first discuss overhead costing of manufacturing overhead.

**Methods of segregating semi-variable cost into variable and fixed-** For segregating semi-variable cost into fixed and variable, the following methods are generally followed-

- i) High-point and Low-point method
- ii) Simultaneous equation method
- iii) Method of Least Square
- iv) Scatter Diagram method.

Of the above, method (i) and (ii) are discussed for solving the problems in the preliminary level.

The above two methods are restated with following example. Units produced and total semi-variable costs are as below-

Units	Total Costs
-------	-------------

1000  
2000  
3000  
4000

Rs5000  
Rs6000  
Rs7000  
Rs8000



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Sol:(i) Under High-point and Low-point method-

$$\text{Variable cost per unit} = \frac{\text{High-point cost} - \text{Low-point cost}}{\text{High-point unit} - \text{Low-point unit}}$$

So, variable cost per unit =  $(\text{Rs}8000 - \text{Rs}5000) / (4000 - 1000) = \text{Rs}3000 / 3000 = \text{Rs}1$  per unit  
 Fixed cost = Total cost - variable cost per unit at any level can be applied  
 $= \text{Rs}8000 - 4000 \times 1 = 8000 - 4000 = \text{Rs}4000$ .

(ii) Under simultaneous equation method – Here we have to form two equations to find fixed and variable portion of semi-variable cost.

Let, a = variable cost per unit and b = fixed cost, applying we get

$$1000a + b = 5000 \dots\dots\dots (i)$$

$$4000a + b = 8000 \dots\dots\dots (ii),$$

Solving we get, a = 1 and b = 4000.

**Steps of Factory Overhead costing-** Manufacturing overhead costing comprised of the following steps-

- (i) Collection of factory overhead costs
- (ii) Allocation of overhead costs
- (iii) Apportionment or distribution of overhead costs
- (iv) Re-distribution of service department cost to production department
- (v) Absorption of overheads.

- **Allocation and apportionment-** allocation refers to identification of overhead costs to the cost centre. But apportionment refers to the distribution of overhead cost on some logical base when identification to cost centre is not possible. A cost centre may be a person or location or an equipment or group of these in respect of which cost is ascertained for the purpose of cost control. It may be production cost centre or service cost centre.
- **Apportionment or distribution of overhead costs-** When overheads are not allocable, overheads would be apportioned or distributed on some logical bases, some of these are as below-

Types of expenses	Basis of apportionment
i) Rent, rates and taxes	i) Area occupied/Floorspace
ii) Insurance of Stock	ii) Value of Stock
iii) Insurance of other fixed assets	iii) Value of fixed assets
iv) Depreciation of fixed assets	iv) Value of fixed assets
v) Stores overhead	v) Value of materials
vi) Indirect wages	vi) Direct wages
vii) Indirect materials	vii) Direct materials
viii) Lighting/Electricity expenses	viii) wattage x working hours or No of light points or Space occupied
ix) Power	ix) Kw x working hours or H.P. of machine
x) Canteen expenses	x) No of workers
xi) Supervisor's salary	xi) No of workers
xii) Employee welfare expenses	xii) No of workers

xiii) Workers' compensation insurance  
xiv) General expenses  
xv) Repair & maintenance of assets

xiii) direct wages  
xiv) Working hours or direct wages  
xv) Value of assets



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The above is illustrative and not exhaustive.

Let us discuss the distribution of overheads and re-distribution of service department cost to production department with an illustration.

**III-1.P.** Ltd is a manufacturing company having three production departments A, B and C, and two service departments X and Y. The following is the budget for December, 2019:

	Total
	Rs 500
Rent and rates	0
General lighting	600
Indirect wages	1500
Power	1500
Depreciation of machinery	10000
Sundry expenses	10000

Additional information:

	A	B	C	D	E
	Rs	Rs	Rs	Rs	Rs
Area (sq.m)	2000	2500	3000	2000	500
Value of machinery (Rs)	60000	80000	100000	5000	5000
Machine hour	1000	2000	4000	1000	1000
Light points (nos)	10	15	20	10	5
Direct wages	3000	2000	3000	1500	500
H.P. of machines	60	30	50	10	---
Working hours	6226	4028	4066	---	---

The expenses of D and E are allocated as follows

D	20%	30%	40%	---	10%
E	40%	20%	30%	10%	---

You are required to do the following:

- A statement showing distribution of overheads
- A statement showing re-distribution of service department cost to production department
- Compute overhead recovery rate
- Ascertain total cost of an article if material cost is Rs 50, labour cost is Rs 30 and it passes through departments A, B and C for 4, 5 and 3 hours respectively.

Sol: We shall discuss the theory while solving the problem:

### (i) Statement showing distribution of overheads

Item of expenses	Basis of apportionment	Total (Rs)	Production Deptt			Service Deptt	
			A	B	C	D	E
Rent and rates	Floor Space	5000	1000	1250	1500	1000	250
General Lighting	Light points	600	100	150	200	100	50
Indirect wages	Direct wages	1500	450	300	450	225	75
Power	H.P. of machine	1500	600	300	500	100	---
Depreciation	Value of machine	10000	2400	3200	4000	200	200
Sundries	Direct wages	10000	3000	2000	3000	1500	500
Direct wages	Actual	2000	---	---	---	1500	500

	<b>TOTAL</b>	30600	7550	7200	9650	4625	1575
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**Note:** Direct wages of production departments are included in the prime cost. However, direct wages of service department though it is direct in nature, but from the point of view of production as it is not producing any goods or services, hence direct wages of service department should be treated as indirect wages and accordingly overhead from the point of view of production department. So is the case for direct materials of service department.

## • Re-distribution of service department cost to production department

For re-distribution of service department cost to production department the following methods are used depending upon the services rendered by the service department.

- i) Direct service to production department only
- ii) One-way service to production department and service department i.e. besides giving service to production department one service department gives service to another service department only.
- iii) Reciprocal service given by the service departments i.e. the service departments are giving services to each other.

**Case-I** - Suppose in the above illustration both the service departments D and E give service in the ratio of 3:1:1 and 2:2:1 to A, B and C respectively. In that case re-distribution statement will be as under:

Statement showing re-distribution of overheads

Item of expenses	Production Deptt			Service Deptt	
	A	B	C	D	E
Total Overhead	7550	7200	9650	4625	1575
Service department D (3:1:1)	2775	925	925	(4625)	---
Service department E (2:2:1)	945	315	315	---	(1575)
Total	11270	8440	10890	Nil	Nil

**Case-II** - Service department D renders service to E worth Rs 2000 and the balance to A, B and C in the ratio of 3:1:1, while service department E provides service only to A, B and C in the ratio of 2:2:1. In that case re-distribution will be as under-

Statement showing re-distribution of overheads

Item of expenses	Production Deptt			Service Deptt	
	A	B	C	D	E
Total Overhead	7550	7200	9650	4625	1575
Service department D to E	---	---	---	(2000)	2000
Service department D to Production Deptt (3:1:1)	1575	525	525	(2625)	---
Total	9125	7725	10175	Nil	3575
Service department E to Production Deptt (2:2:1)	2145	715	715	---	(3575)
	11270	8440	10890	Nil	Nil

**Case-III** - Reciprocal services by one service department to another as given in the illustration:

In this case we may follow either a) Repeated distribution method or b) Simultaneous equation method

**Repeated distribution method:** in this case, service department with higher cost may be considered first

and distributing in the given ratio to production and other service department. This process will continue until the entire service department costs are exhausted.



## Statements showing re-distribution of overheads

Item of expenses	Production Deptt			Service Deptt	
	A	B	C	D	E
Total Overhead	7550	7200	9650	4625	1575
Service department D (2:3:4:1)	925	1388	1850	(4625)	462
Service department E (4:2:3:1)	815	407	611	204	(2037)
Service department D (2:3:4:1)	41	61	82	(204)	20
Service department E (4:2:3:1)	8	5	7	---	(20)
Total Overhead	9339	9061	12200	Nil	Nil

In the last step, share of cost of D from E will be distributed to A, B and C as it is negligible.

**Simultaneous equation method-** In this case we first construct two simultaneous equations to find the total cost of each service department, then the same will be distributed.

Let,

a = Total cost of department D after receiving 10% share of E department's cost

b = Total cost of department E after receiving 10% share of D department's cost

Then,  $a = 4625 + 0.10b$ .....(i)

$b = 1575 + 0.10a$ .....(ii) solving we get  $a = 4831$  and  $b = 2058$

## Statements showing re-distribution of overheads

Item of expenses	Production Deptt			Service Deptt	
	A	B	C	D	E
Total Overhead	7550	7200	9650	4625	1575
Service department D (2:3:4:1)	966	1449	1932	(4831)	483
Service department E (4:2:3:1)	823	412	618	206	(2058)
	9339	9061	12200	Nil	Nil

- **Absorption/ recovery of overheads:** The above table shows that each department's total overhead cost represent its own cost plus share of joint cost and share of service department cost. This total cost is now be charged to cost unit on some reasonable basis. This is called absorption of overhead. Basis of overheads absorption depends upon the process of production adopted in a particular department. There are different methods of absorption of overheads. Such methods are –
  - a) Production unit method (applicable in case of same products)
  - b) Percentage of value of raw material
  - c) Percentage of Direct labour cost (Applicable in case production process is labour intensive and depends on labour time and type)
  - d) Labour hour rate method (Applicable in case production process is labour intensive and depend on labour time)
  - e) Machine hour rate method. (Applicable in case production process is machine based)

The method of overhead absorption to be applied depends upon the production process in operation in a particular department. For example, where the production is labour intensive, labour hour rate method may

be most appropriate; similarly where production is machine based only, machine hour rate method should be applied.

Thus in the given illustration, let us calculate overhead absorption or recovery rate depending upon the working hours given. The absorption rate may be computed separately or it may be computed in the re-distribution statement itself.

Overhead absorption rate =  $(\text{Total overheads of the cost centre}) / \text{quantum of absorption base}$



Here, Overhead absorption rate will be –  
 Department A = Rs 9339/6226 hrs = Rs 1.50  
 Department B = Rs 9061/4026hrs = Rs 2.25  
 Department C = Rs 12200/4066hrs = Rs 3.00

After determining the overhead absorption rate the cost of product is determined as below. In the given illustration the same is computed as below:

### Statements showing cost of the articles

		Rs
Raw materials		50
Labour cost		30
Overheads:		
Deptt A = 4hrs x Rs 1.50	6.00	
Deptt B = 5hrs x Rs 2.25	11.25	
Deptt C = 3hrs x Rs 3.00	9.00	26.25
	<u>          </u>	<u>          </u>
Total Cost		<u>106.25</u>

- **Absorption of overheads on the basis of Machine Hour Rate:** Where the production in the factory is purely based on machine work, absorption rate will be adopted as machine hour rate. A standard format of which may be followed as below-

### Computation of Machine Hour Rate

Original Cost of Machine	-√
(+) Installation Charges	-√
(+) Carriage etc	-√
Capital Cost	√
Less: Scrap value	√
	<u>          </u>
Depreciation	√
Estimated Life	---yrs

Item of expenses	Amount (Rs)	Amount (Rs per hour)
------------------	-------------	----------------------

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A. FixedExpenses(illustrativeonly)			
Rent, rates and taxes		---	
Insurance		---	
Electricity Charges		---	
Supervisor'sSalary		---	
	Totalfixedexpenses	---	
B. <u>EffectiveMachineHour</u>			
MachineHourbooked	---		
Less:NormalIdleTime	---		
Effectivemachinehour	---		
C. Fixedexpensesperhour (A/B)			---
D. <u>Variableexpensesperhour</u>			
Depreciation=AnnualDep/B			---
Repairandmaintenance=TotalReaircost/B			---
Power = Power cost/ B			---
MachineHourRate			---

**Comprehensive machine hour rate-** In case of comprehensive machine hour rate, wages of operator will be added with the above determined rate. This is mainly because when the production process is entirely machine operated except operators are engaged for its running, then in that case instead of charging operator's wages as direct wages the same is added with the overhead cost to find comprehensive rate.



- **Over or Under Absorption of Overheads:** Before we discuss over or under absorption let us say how many overhead absorption rates are there. There are four absorption rates.
  - Normal rate =  $\frac{\text{Actual overhead incurred}}{\text{Actual quantum of absorption base}}$
  - Pre-determined rate =  $\frac{\text{Budgeted overhead}}{\text{Budgeted quantum of absorption base}}$
  - Blanket Overhead Rate =  $\frac{\text{Total Budgeted overhead}}{\text{Total quantum of estimated base}}$
  - Departmental Overhead Rate =  $\frac{\text{Total Budgeted or estimated overhead for each department}}{\text{Departmental absorption base}}$

Where overhead absorption rate is based on historical cost, there will be no over or under absorption of overhead. However, where absorption of overheads is done on the basis of estimated overheads, the rate determined will be pre-determined overhead rate and there will be a chance of over or under absorption of overhead. Blanket rate is basically applicable for single product organisation, while departmental overhead rate is applicable in case of multiple product organisations. However, over or under absorption occur if-

$$\begin{aligned} \text{Over absorption of overhead} &= \text{Estimated Absorbed} > \text{Actual Overhead incurred} \\ \text{Under absorption of overhead} &= \text{Estimated Overhead} < \text{Actual Overhead} \end{aligned}$$

Such over or under absorption of overheads occur may be due to-

- Wrong estimation of overheads or wrong estimation of absorption base.
- Unanticipated change in the level of production
- When there is significant change in the prices of materials and direct labours and recovery is done on the basis of materials and labour costs
- If technology or production process is changed and as a result there is a change in overhead costs.

III2- The budget of a machine shop for 2018-19 is as follows:

Normal working week	42 hours
Number of machines	15
Hours spent on maintenance per week (normal loss)	5 hrs per machine
Estimated annual overhead	Rs 5,55,000
Number of working weeks in 2018-19	50
The actuals in respect of 4-week period in 2018-19 are:	
Overhead incurred	Rs 49,000
Machine hour worked	2400

- Calculate: a) Overhead rate per machine hour for 2018-19  
 b) The amount of over or under absorption of overhead in respect of the 4-week period.

Sol. Machine hour worked = Working weeks x working hours per week x no. of machine - Normal idle time  
 $= 50 \text{ weeks} \times 42 \text{ hours} \times 15 - 15 \times 5 \times 50$   
 $= 31,500 - 3750 = 27750 \text{ hrs}$

Machine hour rate =  $\frac{\text{Total estimated annual overhead}}{\text{machine hour worked}}$   
 $= \frac{\text{Rs } 5,55,000}{27750} = \text{Rs } 20$

Computation of Over or under absorption of Overhead

	Rs
Overhead incurred	49,000
Overhead absorbed [Rs 20 x 2400 hrs]	48,000
	_____
Underabsorption	1,000

• **Treatment of over or under absorption of overhead:** Over or under absorbed overheads may be treated in three different ways. However a particular method is applicable depending upon the reasons of arising over or under absorption of overheads.

- i) The amount may be carried forward to next year
- ii) The amount may be charged to costing profit & loss account.
- iii) The amount may be adjusted through supplementary rate.



- Carried forward to next year- In this case over or under absorption of overhead is carried forward to next year through overhead reserve account for charge. However, such treatment is not acceptable as it ignores matching concept, because instead of charging or crediting current year's item in current year, the same is deferred for adjustment. It is basically accepted when, reasons for over or under absorption are not readily determinable.
- Charging to Costing Profit & Loss Account – When the over or under absorption of overhead is negligible or even where it is significant but it arises due to abnormal reasons the same should be charged to costing profit and loss account.
- Use of Supplementary Rate - This method is used when such over or under absorption arises due to wrong estimation of overheads, major change in the production method, error in estimating the recovery base. Let us first understand use of supplementary rate in case of under absorption of overhead. Later overabsorption will follow automatically. Suppose overhead absorbed = Rs 1, 00,000 and overhead incurred = Rs 1,20,000. So there is under absorption = Rs 20,000. Overheads charged to current year's cost is Rs1,00,000, thereby cost is lower by Rs 20,000 and accordingly, increase in profit by the same amount. Thus, adjustment to be made in the current year with respect to the output produced. But output produced consists of full finished or half-finished goods and even for full finished goods a portion may remain unsold. So adjustment to be made to finished goods sold and the balance to be deferred for charge through Stock of WIP and that of Finished Goods.

$$\text{Supplementary rate} = \frac{\text{Over or under absorption of Overhead}}{\text{Actual activity level}}$$

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# **GOKUL GLOBAL UNIVERSITY**

Faculty of Commerce & Management

E-Content



<b>Course:</b>	Bachelor of Business Administration
<b>Semester:</b>	3 <sup>rd</sup>
<b>Subject:</b>	Introduction To Entrepreneurship
<b>Subject Code:</b>	FMB230105

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**Prepared By:** Mr. Shamim A Sulemani

# Bachelor of Business Administration (BBA)

**Subject / Branch:** Management

**Year:** 2nd Year

**Semester:** 3rd

**Course Title:** Introduction to Entrepreneurship

**Course Code:** FMB230106

**Course Type:** Core Compulsory

**Course Credit:** 04

## Pre-Requisite

10+2 (Commerce) from a recognized education board.

## Rationale of the Course

This course is designed to introduce students to the **fundamentals of entrepreneurship**, startup thinking, innovation, and opportunity recognition. It helps learners understand how entrepreneurial ideas are generated, transformed into startups, and scaled into successful ventures. The course also builds awareness about **entrepreneurial mindset, startup teams, founders' roles, and design thinking**, preparing students for entrepreneurial careers and business leadership.

## Teaching & Examination Scheme

Teaching (Hours / Week)	Examination Scheme	Marks
Lecture	Internal Assessment	30
4	Mid: 20	
Tutorial	CE: 10	
0	External Examination	70
Practical	Total	100
0		

## Course Objectives

1. To understand the concept of entrepreneurship and its role in the business world.

2. To differentiate between entrepreneurs and small business owners.
3. To develop an entrepreneurial mindset focusing on creativity, innovation, and risk-taking.

## **Course Outcomes**

After completing the course, students will be able to:

1. Understand the meaning and classifications of entrepreneurship.
2. Analyze opportunities using internal and external business analysis.
3. Understand the components and importance of a business plan.
4. Understand the role of marketing planning in entrepreneurial success.

# **UNIT – I : INTRODUCTION TO ENTREPRENEURSHIP**

**Credit Weightage:** 25%

## **1. Meaning of Entrepreneurship**

Entrepreneurship is the process of identifying opportunities, organizing resources, and taking calculated risks to create value through a new business or innovation.

## **2. How Entrepreneurship Has Changed the World**

Entrepreneurship contributes to economic growth, employment generation, innovation, social development, and global connectivity. Entrepreneurs introduce new products, improve services, and solve societal problems.

## **3. Entrepreneurial DNA**

Entrepreneurial DNA refers to the mindset, traits, skills, and attitudes that enable individuals to think and act like entrepreneurs. It can be developed through learning, training, and experience.

## **4. Entrepreneurial Traits & Gap Analysis**

Traits include risk-taking, creativity, leadership, persistence, and adaptability. Gap analysis identifies differences between existing skills and required entrepreneurial skills.

## **5. Entrepreneurship Cells (E-Cells)**

E-Cells are student-driven bodies in educational institutions that promote entrepreneurship through workshops, mentoring, startup support, and innovation activities.

## **6. Why Join an E-Cell**

E-Cells help in skill development, practical exposure, networking, confidence building, startup support, and career readiness.

## **7. Entrepreneurial Success Stories**

Successful entrepreneurs inspire students by showing how innovation, persistence, and execution lead to success.

# **UNIT – II : UNDERSTANDING STARTUPS**

**Credit Weightage:** 25%

## **1. Meaning and Types of Startups**

Startups are newly established businesses designed to grow rapidly through innovation. Types include small business startups, scalable startups, technology startups, social startups, lifestyle startups, and corporate startups.

## **2. Your Great Business Idea**

A great startup idea solves a real problem, meets customer needs, and has market demand. Idea validation is essential before launch.

## **3. Understanding Competition**

- Direct competitors
- Indirect competitors
- Potential competitors

Understanding competition helps in pricing, positioning, and strategy development.

## **4. Pivoting the Business Idea**

Pivoting means changing product, customer segment, revenue model, or technology to avoid failure and improve market fit.

## **5. Importance of Startup Team & Role of Founders**

Startups succeed through teamwork, not individual effort.

**No “I” Concept:** Emphasizes collaboration and shared responsibility.

### **Team Formation:**

- Visionary leader
- Technical expert

- Business/marketing strategist
- Finance & operations support

#### **Qualities of a Founder:**

- Recruiter
- Decider
- Deal Maker
- Strategist

## **UNIT – III : CASES OF SUCCESSFUL STARTUPS**

**Credit Weightage:** 25%

This unit focuses on understanding how real startups succeeded through innovation, strategy, and execution.

#### **Case Studies Covered:**

- OYO – Budget hospitality standardization
- Ola – App-based urban transportation
- Airbnb – Global home-sharing platform
- Facebook – Social media networking
- Inshorts – 60-word news consumption
- Paytm – Digital payments ecosystem

#### **Learning Focus:**

- Business model
- Growth strategy
- Technology usage
- Key success factors

## **UNIT – IV : PHASES OF STARTUPS & DESIGN THINKING**

**Credit Weightage:** 25%

### **A. Phases of Startups**

1. **Pre-Company Formation Stage** – Idea generation, feasibility analysis, market research.
2. **Startup / Company Formation Stage** – Legal registration, MVP launch, early customers.

3. **Development Stage** – Product improvement, operational stability, branding.
4. **Growth Stage** – Market expansion, scaling, funding, organizational structure.
5. **Preparation for Exit** – Acquisition, merger, IPO, or strategic exit planning.

## B. Design Thinking

Design Thinking is a human-centered innovation approach.

1. **Empathise** – Understand user needs and problems
2. **Define** – Clearly define the core problem
3. **Ideate** – Generate multiple creative solutions
4. **Prototype** – Build low-cost working models
5. **Test** – User testing and feedback for improvement

## Practical / Activities

1. Quiz using Google Forms
2. Startup idea presentation
3. Case discussion in breakout rooms
4. Design thinking activity (problem to prototype)

## Reference Books

1. Operation Research and Statistical Analysis – P. K. Gupta & Manmohan
2. Quantitative Techniques in Management – Tata McGraw Hill
3. Elements of Business Mathematics – Soni, Sharma & Saxena
4. Mathematics for Management – Bronson & Bronson

## Suggested Readings

- Elements of Business Mathematics – Pitamber Publications
- Mathematics for Management – Bronson & Bronson

## Online Resources

- [www.pdfdrive.com](http://www.pdfdrive.com)
- [www.slideshare.net](http://www.slideshare.net)



## **Module 1**

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## INTRODUCTION TO ENTREPRENEURSHIP

### What is Entrepreneurship?

Entrepreneurship is the process of identifying business opportunities, taking risks, and organizing resources to create value through new products, services, or innovative solutions. An entrepreneur is a person who starts, manages, and grows a business by combining creativity, innovation, and managerial skills.

In simple words, entrepreneurship means turning ideas into action and creating something useful for society while earning profit.

Entrepreneurship is not limited to starting big companies; it also includes:


#### 1. Small Businesses



### Small Business

*['smɒl 'biz-nəs]*

A company of relatively limited size, as measured by its revenue, number of employees, or both.

 Investopedia

Small businesses are independently owned enterprises that operate on a limited scale.

#### Key Features:

- Usually owned and managed by individuals or families
- Operate locally or regionally
- Require low to moderate capital
- Focus on steady income rather than rapid growth

**Examples:**

Retail shops, restaurants, salons, repair services, local manufacturers.

**Importance:**

- Generate local employment
- Support regional economic development
- Promote self-employment
- Provide personalized services to customers

Small businesses form the backbone of many economies, especially in developing countries.

**2. Start-ups**

Start-ups are newly created businesses designed to grow rapidly using innovation.

**Key Features:**

- Based on new ideas, technology, or business models
- High growth and scalability potential
- Often funded by angel investors or venture capital
- Higher risk but higher reward

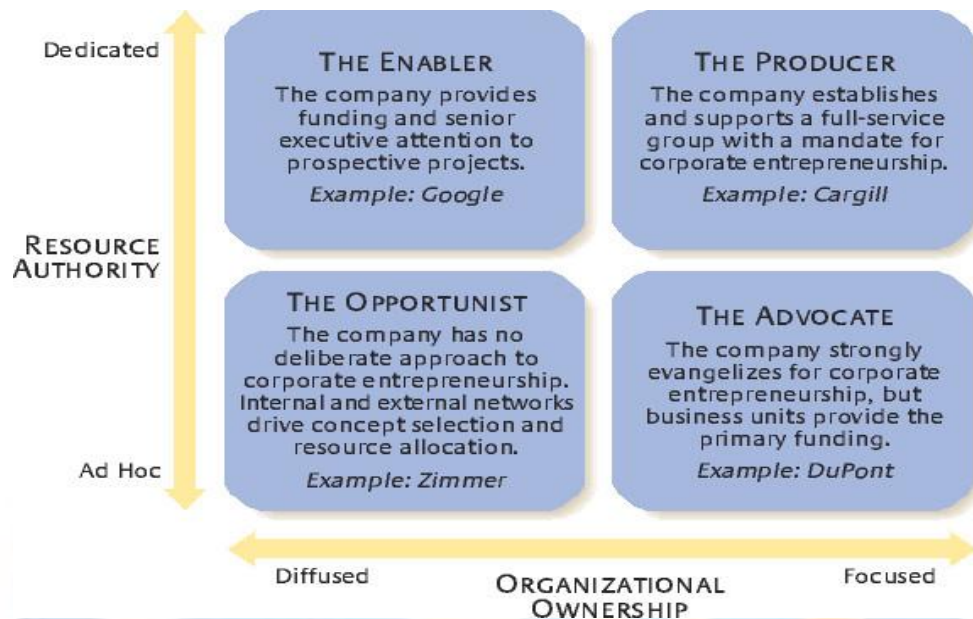
**Examples:**

Technology apps, fintech companies, ed-tech platforms, online marketplaces.



Social enterprises prove that businesses can be both ethical and impactful.

#### 4. Innovation within Existing Organizations (Intrapreneurship)



Intrapreneurship refers to entrepreneurial activities carried out by employees within an existing organization.

#### Key Features:

- Employees act like entrepreneurs
- Use company resources and infrastructure
- Encourage creativity, innovation, and risk-taking
- Focus on new products, services, or processes

#### Examples:

- Developing a new product line
- Improving internal systems through technology
- Launching new business units

#### Importance:

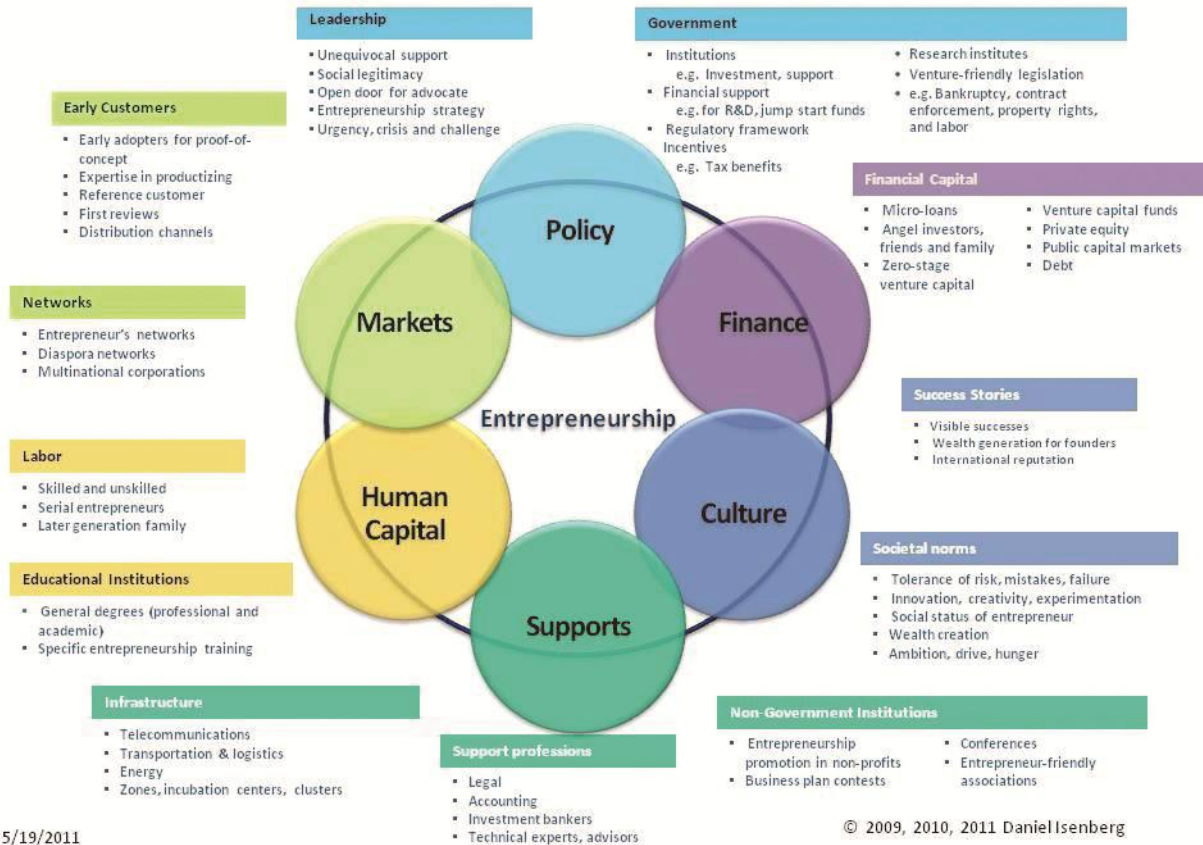
- Keeps organizations competitive
- Encourages employee motivation and creativity
- Reduces resistance to change
- Promotes continuous innovation

Intrapreneurship helps large organizations stay dynamic in a fast-changing business environment.

# How Has Entrepreneurship Changed the World?



## Domains of the Entrepreneurship Ecosystem



5/19/2011

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Entrepreneurship has been one of the most powerful forces behind economic, social, and technological transformation across the world. By converting ideas into action, entrepreneurs have reshaped industries, improved living standards, and created new ways of working and connecting. Its impact can be clearly understood through the following dimensions:

### 1. Economic Growth

Entrepreneurship plays a vital role in strengthening both national and global economies by encouraging the creation of new businesses across manufacturing, services, technology, agriculture, and other sectors. These enterprises generate revenue, profits, and tax income, which increases national income and supports government development activities. As entrepreneurs produce goods and services, they contribute directly to Gross Domestic Product (GDP). Moreover, small and medium enterprises promote balanced regional development by generating economic activity in rural and semi-urban areas, thereby reducing regional inequalities. Overall, entrepreneurship acts as a strong engine of sustainable economic development.

## 2. Employment Generation

One of the most visible contributions of entrepreneurship is employment creation. New start-ups and small businesses provide direct employment opportunities in areas such as production, marketing, finance, information technology, and management. In addition to direct jobs, entrepreneurship also creates indirect employment by supporting related industries like transport, logistics, suppliers, and service providers. Through self-employment and enterprise creation, entrepreneurship reduces unemployment and poverty, particularly among youth and women. Thus, it not only creates wealth but also ensures a wider distribution of income across society.

## 3. Innovation and Technological Advancement

Entrepreneurs are key drivers of innovation and technological progress. They introduce and adopt new technologies such as artificial intelligence, fintech solutions, biotechnology, and green energy, which transform traditional ways of doing business. Continuous innovation results in improved products and services with better quality, lower costs, and higher customer satisfaction. The use of automation and digital tools increases productivity and operational efficiency. Innovations in communication, transportation, healthcare, and education significantly enhance the quality of life. In this way, entrepreneurship converts creative ideas into practical solutions that benefit society.

## 4. Social Development and Inclusive Growth

Entrepreneurship goes beyond profit-making and plays an important role in addressing social challenges. In the education sector, ed-tech start-ups make learning more affordable and accessible. Health-tech ventures improve healthcare delivery through better diagnostics, digital records, and telemedicine services. Environmental entrepreneurs focus on renewable energy, waste management, and eco-friendly products to protect the environment. Women-led enterprises promote financial independence, self-confidence, and social empowerment. Through social entrepreneurship, business becomes an effective tool for inclusive growth and positive social change.

## 5. Global Connectivity and Digital Transformation

Entrepreneurship has significantly increased global connectivity through digital transformation. E-commerce platforms enable businesses to sell products and services worldwide without physical boundaries. Digital start-ups offering apps, software-as-a-service (SaaS), and online platforms connect customers across countries in real time. This provides global market access even to small start-ups, allowing them to compete with large international firms. Cross-border entrepreneurship also promotes cultural exchange and the sharing of ideas and innovations. As a result, entrepreneurship has transformed the way people communicate, trade, and collaborate globally.

## Entrepreneurial DNA

Entrepreneurial DNA refers to the combination of natural traits and developed qualities that shape a person's ability to think, behave, and act like an entrepreneur. It includes mindset, attitudes, skills, and behavioral patterns that help individuals identify opportunities, take initiative, and create value. Entrepreneurial DNA is not limited to people who start businesses; it is equally important for managers, leaders, and innovators in all types of organizations.

Although some individuals may be born with certain entrepreneurial traits, Entrepreneurial DNA is **not purely inborn**. It can be strengthened and developed through education, training, real-life experiences, and continuous learning.

### Key Elements of Entrepreneurial DNA

#### 1. Entrepreneurial Mindset

An entrepreneurial mindset involves the ability to see opportunities where others see problems. Entrepreneurs think creatively, remain positive in uncertain situations, and are willing to experiment with new ideas. They focus on long-term goals while adapting quickly to changes in the environment.

#### 2. Risk-Taking Ability

Entrepreneurs are willing to take calculated risks. They analyze situations carefully, evaluate possible outcomes, and make informed decisions despite uncertainty. This willingness to step outside comfort zones is essential for innovation and growth.

#### 3. Creativity and Innovation

Entrepreneurial DNA includes the ability to generate new ideas and convert them into useful products or services. Entrepreneurs continuously seek better ways of doing things, improve existing systems, and introduce innovative solutions to market needs.

#### 4. Leadership and Decision-Making

Entrepreneurs often act as leaders who inspire and guide others. Strong decision-making skills help them choose the right course of action at the right time, even with limited resources or information. Effective leadership also helps in building teams and motivating employees.

#### 5. Self-Confidence and Initiative

Entrepreneurs believe in their abilities and take initiative without waiting for instructions. Self-confidence allows them to face criticism, handle failures, and remain committed to their vision.

#### 6. Problem-Solving and Resilience

Challenges and failures are common in entrepreneurial journeys. Entrepreneurial DNA includes resilience—the ability to recover from setbacks, learn from mistakes, and continue moving forward. Entrepreneurs view problems as learning opportunities rather than obstacles.

#### 7. Continuous Learning and Adaptability

Successful entrepreneurs constantly update their knowledge and skills. They adapt to market

changes, customer needs, and technological advancements. Learning from experience, mentors, and feedback helps strengthen entrepreneurial capability.

### Development of Entrepreneurial DNA

Entrepreneurial DNA can be developed through:

- Education in entrepreneurship and management
- Skill-based training and workshops
- Practical experience through projects, internships, or start-ups
- Mentorship and networking
- Learning from failures and real-world challenges

## Entrepreneurial Gap Analysis



Entrepreneurial Gap Analysis is a systematic process used to identify the difference between an individual's **existing skills, knowledge, and abilities** and the **skills required to become a successful entrepreneur**. It helps aspiring entrepreneurs clearly understand where they currently stand and what they need to improve in order to achieve entrepreneurial success. This analysis is useful for students, start-up founders, and professionals who wish to develop entrepreneurial capabilities.

Entrepreneurial gap analysis is not a one-time activity; it is a continuous process that supports personal growth, adaptability, and long-term success in a dynamic business environment.

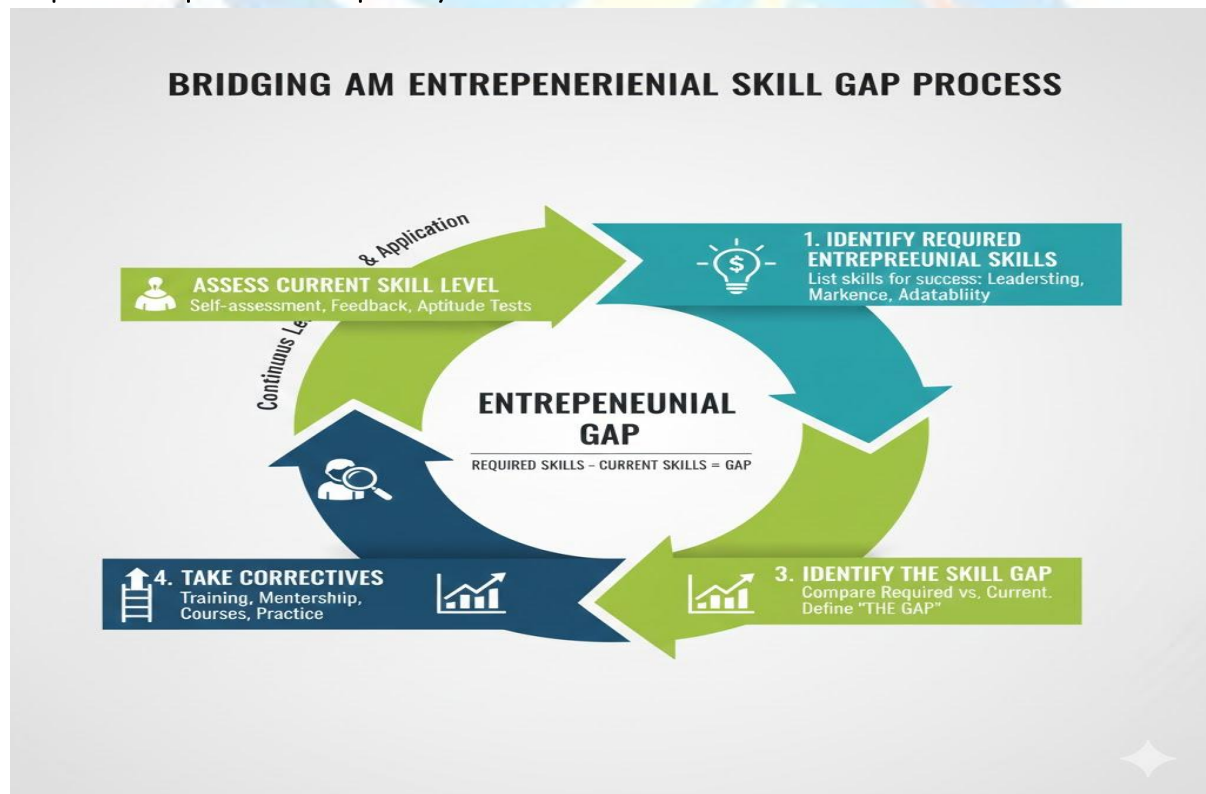
## Purpose of Entrepreneurial Gap Analysis

The main purpose of entrepreneurial gap analysis is to understand **personal strengths and weaknesses**. By evaluating one's current abilities, individuals can recognize areas where they perform well and areas that need improvement. This self-awareness builds confidence and provides clarity in decision-making.

Another important purpose is to **identify skill gaps**. Entrepreneurship requires a wide range of skills such as leadership, risk management, communication, financial planning, innovation, and problem-solving. Gap analysis highlights missing or weak skills that may limit entrepreneurial performance.

Entrepreneurial gap analysis also helps to **plan training and development** activities. Once gaps are identified, individuals can choose suitable courses, workshops, mentorship programs, or practical experiences to improve their entrepreneurial competence. This ensures focused and effective skill development rather than random learning.

## Steps in Entrepreneurial Gap Analysis



### 1. Identify Required Entrepreneurial Skills

The first step is to list the skills needed for successful entrepreneurship. These may include opportunity identification, creativity, leadership, communication, financial management, marketing, decision-making, risk-taking, and adaptability. The required skills may vary depending on the type of business or industry.

### 2. Assess Current Skill Level

In this step, individuals evaluate their present skills honestly. This can be done through self-assessment, feedback from mentors or teachers, performance reviews, aptitude tests, or

practical experience. The goal is to understand the current level of competence in each entrepreneurial skill.

### **3. Identify the Skill Gap**

The third step involves comparing required skills with existing skills. The difference between what is required and what is currently possessed is known as the entrepreneurial gap. Some skills may show a small gap, while others may require significant improvement.

### **4. Take Corrective Measures**

After identifying the gaps, corrective actions are taken to bridge them. These may include formal training programs, online courses, workshops, mentoring by experienced entrepreneurs, internships, practical projects, or hands-on business experience. Continuous practice and learning help reduce the gap over time.

## **What are E-Cells (Entrepreneurship Cells)?**

E-Cells, also known as **Entrepreneurship Cells**, are **student-driven organizations** established in colleges and universities with the aim of promoting an entrepreneurial culture among students. These cells work as a platform where students are encouraged to think creatively, develop business ideas, and explore entrepreneurship as a viable career option alongside traditional employment.

E-Cells function under the guidance of faculty members, industry experts, entrepreneurs, and incubation centers. They help students transform theoretical knowledge into practical entrepreneurial skills by exposing them to real-world business challenges and opportunities.

### **Objectives of E-Cells**

#### **1. Encourage Entrepreneurial Thinking**

One of the primary objectives of E-Cells is to develop an entrepreneurial mindset among students. They motivate students to think innovatively, identify problems, and look for business-oriented solutions. Through discussions, case studies, and idea-generation sessions, E-Cells help students move beyond job-seeking and consider job-creation.

#### **2. Provide Practical Exposure**

E-Cells bridge the gap between classroom learning and real-world entrepreneurship. They organize workshops, seminars, boot camps, industrial visits, and business simulations that give students hands-on exposure to business planning, market research, funding, and operations. This practical learning builds confidence and decision-making ability.

#### **3. Support Start-up Ideas**

E-Cells actively support students who have start-up ideas. They provide guidance on idea validation, business model development, pitch preparation, and prototype creation. Many E-Cells collaborate with incubation centers, accelerators, and investors to help students convert ideas into viable start-ups.

#### **4. Create Awareness about Innovation and Start-ups**

E-Cells create awareness about innovation, start-up ecosystems, government schemes, funding opportunities, and entrepreneurship policies. By inviting successful entrepreneurs

and start-up founders for talks and mentoring sessions, E-Cells inspire students and expose them to real entrepreneurial journeys.

## **Why Join an E-Cell (Entrepreneurship Cell)?**

Joining an **E-Cell (Entrepreneurship Cell)** provides students with a unique platform to explore entrepreneurship, develop essential skills, and gain real-world exposure beyond classroom learning. The benefits of joining an E-Cell are explained in detail below:

### **1. Skill Development**

Being an active member of an E-Cell helps students develop essential professional and entrepreneurial skills. Leadership skills are enhanced through team coordination and event management. Communication skills improve through presentations, pitching ideas, and interacting with professionals. Students also learn planning, problem-solving, time management, and decision-making, which are crucial for both entrepreneurship and corporate careers.

### **2. Practical Exposure**

E-Cells focus on learning by doing. Students gain hands-on experience through workshops, boot camps, start-up events, business plan competitions, and hackathons. These activities expose students to real business challenges such as market analysis, product development, customer validation, and pitching to judges or investors, making learning more practical and impactful.

### **3. Networking Opportunities**

E-Cells provide valuable networking opportunities by connecting students with entrepreneurs, start-up founders, mentors, investors, industry experts, and incubation centers. Interaction with experienced professionals helps students gain insights into real entrepreneurial journeys, market realities, and funding processes. Networking also opens doors to internships, mentorship, and future business collaborations.

### **4. Confidence Building**

Participation in E-Cell activities boosts self-confidence. Students are encouraged to share ideas, present business models, and take leadership roles. Regular exposure to public speaking, teamwork, and competitions reduces fear of failure and builds a proactive attitude. This confidence helps students take initiative and handle challenges effectively.

### **5. Start-up Support**

E-Cells actively support students who wish to start their own ventures. They provide guidance in idea validation, business plan preparation, pitch deck creation, prototype development, and understanding funding options. Through mentorship and incubation support, students receive structured assistance to transform innovative ideas into viable start-ups.

## 6. Career Advantage

Joining an E-Cell offers a strong career advantage. The skills, exposure, and experience gained improve employability and make students industry-ready. Recruiters value candidates with entrepreneurial mindset, leadership qualities, and problem-solving abilities. For aspiring entrepreneurs, E-Cell experience builds a strong foundation for launching and managing start-ups successfully.

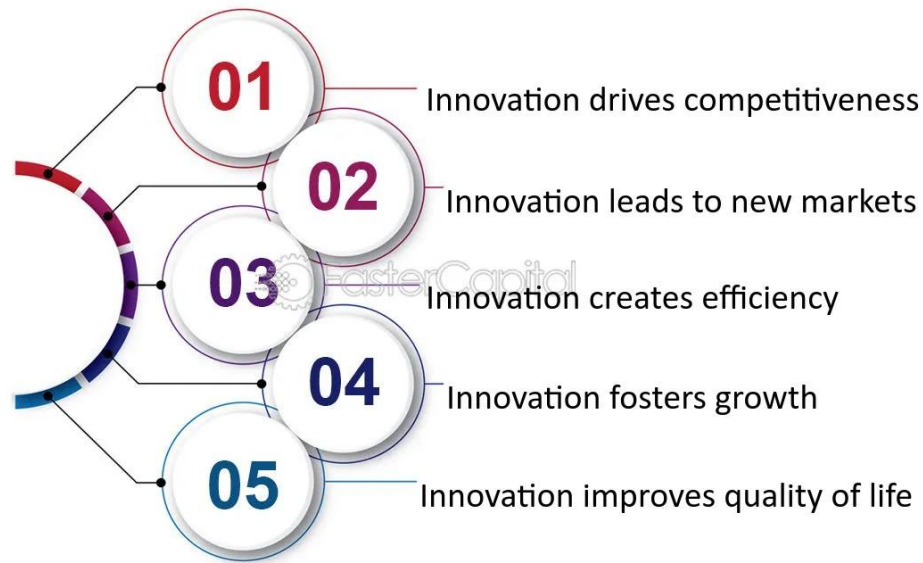
## Entrepreneurial Success Stories



Entrepreneurial success stories inspire individuals by proving that **ordinary people can achieve extraordinary success** through innovation, hard work, and determination. These stories often begin with limited resources, uncertainty, and challenges, yet end with remarkable achievements. They motivate students and aspiring entrepreneurs to believe in their ideas, take calculated risks, and remain committed to their goals. Success stories also provide practical lessons that help individuals understand the real-world journey of entrepreneurship beyond theory.

### Key Lessons from Entrepreneurial Success Stories

# The Role of Innovation in Entrepreneurship



## 1. Start Small, Think Big

Most successful entrepreneurs began with small ideas, limited capital, and modest resources. Instead of waiting for perfect conditions, they took the first step with what they had. Over time, they expanded their vision, improved their offerings, and scaled their businesses. This teaches that starting small is not a limitation; having a big vision and long-term goals is what drives growth and success.

## 2. Failure is Part of Learning

Entrepreneurial success stories clearly show that failure is not the end but a stepping stone to success. Many entrepreneurs faced rejection, financial loss, product failure, or business setbacks. However, they treated failures as learning experiences, analyzed their mistakes, and improved their strategies. This lesson encourages individuals to view failure positively and develop resilience rather than fear risk.

## 3. Innovation Creates Opportunity

Innovation lies at the heart of most success stories. Entrepreneurs identified gaps in the market and introduced new products, services, or business models to solve problems. By thinking creatively and offering better solutions, they created opportunities not only for themselves but also for others through job creation and improved services. Innovation helps entrepreneurs stay competitive and relevant in changing markets.

## 4. Persistence Leads to Success

Persistence and determination are common traits among successful entrepreneurs. Despite challenges such as competition, lack of funds, or slow growth, they remained consistent in their efforts. Success did not come overnight; it was the result of continuous hard work, patience, and belief in their vision. This lesson highlights the importance of perseverance in achieving long-term goals.

## 5. Vision and Execution Are Equally Important

Having a strong vision gives direction to an entrepreneurial journey, but execution turns ideas

into reality. Success stories show that entrepreneurs who combine clear vision with effective planning, timely decisions, and disciplined execution achieve lasting success. Vision without action remains an idea, while execution without vision lacks purpose. Both are essential for sustainable entrepreneurship.





## Module 2

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# UNDERSTANDING STARTUPS

## Introduction to Startups

A startup is a **new business venture** created to solve a problem or meet a market need through **innovation, scalability, and technology**. Unlike traditional businesses, startups aim for **rapid growth**, experimentation, and disruption of existing markets.

Startups operate in conditions of **high uncertainty**, where learning, adaptation, and speed are more important than fixed plans.

### Types of Startups

Startups can be classified into different types based on their purpose, growth ambition, business model, and overall impact. Understanding these types helps students and aspiring entrepreneurs choose the most suitable path according to their goals, skills, financial capacity, and risk-taking ability.

1. **Small business startups** are created mainly to earn a stable income rather than to grow rapidly or dominate large markets. These startups are usually owned and managed by individuals or families and operate at a local or regional level. They focus on customer satisfaction and steady profits instead of large-scale innovation. Examples include retail shops, restaurants, salons, tuition centers, and local service providers. Such startups require limited capital investment, involve low risk, grow slowly, and are generally financed through personal savings or bank loans. Small business startups are important because they generate local employment and contribute significantly to the economy, especially in developing countries.
2. **Scalable startups** are designed for rapid growth and large market expansion. These startups usually begin with innovative ideas based on technology or unique business models and aim to reach national or global markets. They attract angel investors and venture capital funding to support fast growth and scalability. Examples include technology platforms, SaaS companies, fintech, and ed-tech startups. Scalable startups are characterized by high growth potential, strong reliance on technology, continuous innovation, and external funding. Their importance lies in driving technological advancement, creating high-value employment, and bringing global recognition to the entrepreneurial ecosystem.
3. **Technology startups** focus on developing new technologies or applying existing technologies in innovative ways to solve problems. They use digital solutions such as mobile applications, software, artificial intelligence, blockchain, and cloud computing. Examples include AI tools, software development firms, cybersecurity companies, and app-based businesses. These startups emphasize research and development, employ a skilled workforce, encourage continuous innovation, and operate in highly competitive markets. Technology startups play a crucial role in improving efficiency, productivity, and digital transformation across industries.
4. **Social startups** are established to solve social or environmental problems while remaining financially sustainable. Their primary objective is social impact rather than profit maximization, and any profits earned are reinvested to achieve social goals. These startups focus on areas such as education, healthcare, environmental protection, sanitation, rural development, and women empowerment. Social startups are mission-

driven, impact-focused, ethically operated, and built on sustainable business models. They promote inclusive growth and social welfare by using entrepreneurship as a tool for positive societal change.

5. **Lifestyle startups** are created to support a particular lifestyle choice of the entrepreneur. These startups are built around personal interests, passion, or the desire for flexible working conditions rather than large-scale expansion. Examples include freelancing businesses, content creators, travel bloggers, fitness coaches, and consultants. Lifestyle startups usually require low capital, have limited growth plans, and focus on work-life balance. Their importance lies in providing independence, flexibility, and personal satisfaction while generating income.
6. **Corporate startups**, also known as intrapreneurial startups, are new ventures created within existing large organizations. In these startups, employees act like entrepreneurs and develop innovative products, services, or processes using the company's resources and infrastructure. Examples include internal innovation labs, new digital products, or technology-driven business units. Corporate startups are backed by large firms, face lower risk compared to independent startups, and benefit from strong organizational support. They help companies remain competitive, innovative, and adaptable in a rapidly changing business environment.
7. **Buyable startups** are created with the intention of being acquired by larger companies. These startups focus on building unique technology, intellectual property, or a strong customer base that attracts big firms. Examples include app-based startups that are later acquired by technology giants. Such startups are acquisition-oriented, have short to medium-term goals, and emphasize innovation. They encourage creativity and provide attractive exit opportunities for entrepreneurs and investors.
8. **Large-company transformation startups** are formed by established companies to explore new markets, technologies, or business models when existing ones become outdated. These ventures operate like startups but function under the umbrella of a large corporation. They focus on reinvention, strategic innovation, and long-term survival. Their importance lies in helping companies adapt to changing market conditions, technological disruption, and evolving customer needs.

## Learning Who Can Compete with Your Idea and How



# Types of Competitors

## 1. Direct Competitors

Direct competitors are businesses that offer **similar products or services** to the same target customers and operate in the same market. They try to satisfy the same customer needs using nearly identical offerings. Because of this, competition between direct competitors is usually intense. These competitors closely monitor each other's pricing, quality, marketing strategies, and customer service. For example, two restaurants serving similar cuisine in the same area or two mobile phone brands offering phones in the same price range are direct competitors. Understanding direct competitors helps a business improve its product features, pricing strategy, and customer experience to gain a competitive advantage.

## 2. Indirect Competitors

Indirect competitors are businesses that offer **alternative products or services** that satisfy the same customer need in a different way. Although their offerings are not identical, they compete for the same customer spending. For example, a cinema hall competes indirectly with streaming platforms, or a bicycle company competes indirectly with public transport services. Indirect competition may not be immediately visible, but it strongly influences consumer choices. Businesses must analyze indirect competitors to understand changing customer preferences and potential substitutes that can reduce demand for their products or services.

## 3. Potential Competitors

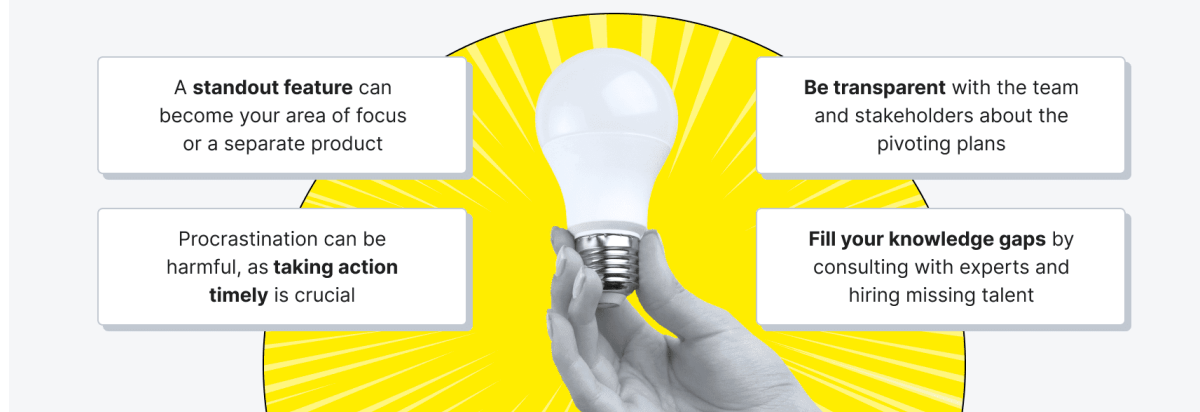
Potential competitors are businesses that **do not currently operate in the market** but may enter it in the future. These competitors may have the resources, technology, brand reputation, or market knowledge to become strong rivals. For example, a large company planning to expand into a new industry or a start-up developing a similar product is a potential competitor. The threat of potential competitors affects long-term business planning, pricing policies, innovation, and market expansion strategies. Companies often create entry barriers such as strong branding, customer loyalty, patents, or cost advantages to protect themselves from future competition.

# When to Pivot Your Business Idea to Avoid Failure

When Should a Startup Pivot?

- Customers are not responding
- Product-market fit is missing
- Revenue is not growing
- Technology is not scalable
- Market conditions have changed

## Tips on Pivoting a Startup



## Types of Pivot in Startups

### 1. Product Pivot

A product pivot occurs when a startup changes or modifies its **product or service** while keeping the core vision of the business intact. This type of pivot is adopted when customer feedback shows that the existing product does not fully meet market needs or lacks demand. The startup may add new features, remove unnecessary ones, redesign the product, or even shift to a completely new product that better solves the customer's problem. Product pivots help startups improve customer satisfaction, usability, and market fit without abandoning their original mission.

### 2. Customer Segment Pivot

A customer segment pivot happens when a startup realizes that its product is valuable, but **not for the originally targeted customers**. In this case, the startup shifts its focus to a new customer group that finds more value in the offering. This pivot often occurs after market testing and user analysis reveal unexpected demand from a different segment. By targeting a new customer group, startups can improve sales, engagement, and long-term sustainability while using the same or slightly modified product.

### 3. Revenue Model Pivot

A revenue model pivot involves changing **how the startup earns money**. Even if customers like the product, the original pricing or revenue strategy may not be profitable or scalable. In this pivot, startups may shift from free to paid models, subscription-based pricing, freemium models, advertising-based revenue, licensing, or pay-per-use models. A revenue model pivot helps startups achieve financial sustainability, attract investors, and ensure long-term business viability.

### 4. Technology Pivot

A technology pivot occurs when a startup changes the **technology used to deliver its product or service** while keeping the same value proposition. This may happen when existing technology becomes outdated, too expensive, inefficient, or unable to scale. Startups may adopt new technologies such as cloud computing, artificial intelligence, automation, or mobile platforms to improve performance, reduce costs, and enhance user experience. Technology pivots allow startups to stay competitive and adapt to rapid technological advancements.

## **Importance of Start-Up Team**

A startup is not built by one person alone. Team strength determines startup success.

### **Why Team Matters**

- Shared responsibility
- Diverse skills and ideas
- Faster problem-solving
- Emotional and operational support

## **Role of Founders in a Startup**

### **No “I” Concept in Startups**

The No “I” Concept highlights that startup success is built on collective effort rather than individual achievement. While founders often receive public recognition, the real strength of a startup lies in its team. Startups operate in uncertain, fast-changing environments where no single person can possess all the required skills. Therefore, collaboration becomes essential.

Founders must promote a culture of teamwork, trust, and transparency. Collaboration ensures that ideas are shared openly, problems are solved faster, and decisions are improved through multiple perspectives. Trust among team members builds confidence and reduces internal conflict, while transparency in communication helps align everyone with the startup’s vision and goals. When team members feel valued and included, they are more motivated to contribute their best efforts. A strong team-oriented culture increases adaptability, innovation, and long-term sustainability of the startup.

### **Team Formation in Startups**

Team formation is one of the most critical steps in building a successful startup. An ideal startup team consists of members with complementary skills, where each individual contributes unique expertise while working toward a common vision.

A visionary leader is essential to define the startup’s mission, long-term goals, and direction. This person inspires the team, takes strategic decisions, and keeps everyone aligned with the startup’s purpose, especially during challenging phases.

A technical expert plays a key role in developing the product or service. This member is responsible for design, development, testing, and technological innovation. Strong technical capability ensures product quality, scalability, and competitive advantage.

A business and marketing strategist focuses on market research, customer acquisition, branding, sales strategies, and partnerships. This role helps the startup understand customer needs, position the product effectively, and generate revenue.

Finance and operations support manages budgeting, accounting, legal compliance, funding, and daily operations. This role ensures efficient use of resources, financial stability, and smooth internal processes, which are crucial for sustainable growth.

## **Qualities of a Founder**

### **1. Founder as a Recruiter**

One of the most important qualities of a founder is the ability to act as an effective recruiter. In the early stages, a startup cannot afford hiring mistakes, so the founder must identify the right talent with suitable skills, attitude, and commitment. A good founder looks beyond qualifications and focuses on cultural fit, passion, and willingness to work in uncertain conditions. By building a motivated and skilled team, the founder ensures that different functions such as technology, marketing, and operations are handled efficiently. The founder also aligns team members with the startup's vision and values, creating a sense of ownership and shared purpose among employees.

### **2. Founder as a Decider**

A founder must be a strong decision-maker, as startups operate in fast-changing and high-risk environments. The founder is required to make timely and sometimes tough decisions related to product development, hiring, pricing, funding, and market entry. Effective founders balance risk and opportunity by analyzing data, market feedback, and intuition before taking action. They do not delay decisions due to fear of failure. Most importantly, a founder takes full responsibility for the outcomes of decisions, whether successful or unsuccessful, and learns from mistakes to improve future choices.

### **3. Founder as a Deal Maker**

Another crucial quality of a founder is the ability to act as a deal maker. Founders regularly negotiate with investors, business partners, suppliers, and customers. Strong negotiation skills help in securing funding on favorable terms, forming strategic partnerships, and closing important business deals. A founder must communicate the startup's vision clearly and convincingly to gain trust and support from stakeholders. By building long-term relationships and alliances, the founder ensures access to financial resources, market opportunities, and industry expertise that are essential for startup growth.

### **4. Founder as a Strategist**

A successful founder must think like a strategist. This involves defining a clear long-term vision and setting achievable goals for the startup. The founder continuously monitors market trends, customer needs, competition, and technological changes. Based on feedback and performance, the founder adapts strategies to remain relevant and competitive. At the same time, the founder balances innovation with sustainability, ensuring that growth does not

compromise financial stability or operational efficiency. Strategic thinking enables the startup to scale responsibly and survive in the long run.





### **Module 3**

विद्या अनन्तम्

## CASE OF SUCCESSFUL STARTUPS

Understanding successful startups helps students learn **how innovative ideas are converted into scalable businesses**, how founders respond to challenges, and how technology and strategy create long-term impact. The following case studies explain the **business model, growth strategy, and key success factors** of well-known startups.

### 1. Case Study: OYO



#### Overview

OYO started as a budget hotel aggregation platform that aimed to standardize affordable hotel rooms for travelers. It focused on improving the quality and consistency of budget accommodation, especially in India where such services were highly unorganized.

#### Key Idea

The core idea was to solve the problem of **unreliable and inconsistent budget hotels** by offering standardized rooms at affordable prices.

## Business Model

OYO partners with small and mid-sized hotels, standardizes rooms using its branding and technology, and earns a **commission on every booking** made through its platform.

## Reasons for Success

OYO succeeded due to its strong use of technology, clear understanding of customer pain points, aggressive expansion strategy, and focus on standardization. Its asset-light model allowed rapid scaling across cities and countries.

## 2. Case Study: Ola



## Overview

Ola transformed urban transportation by connecting drivers and passengers through a mobile application, making travel easier and more affordable.

## Key Idea

The key idea was to make **transportation accessible, affordable, and convenient** for urban and semi-urban users.

## Business Model

Ola operates an app-based ride booking platform and earns revenue by charging **commission from drivers**. It offers multiple services such as cabs, autos, bikes, and electric vehicles.

## Reasons for Success

Ola adapted its services to Indian market needs, built a strong driver network, offered competitive pricing, and continuously diversified its services, including EV mobility.

## 3. Case Study: Airbnb



## Overview

Airbnb allows people to rent out spare rooms or entire homes to travelers, offering unique and affordable accommodation options worldwide.

## **Key Idea**

The idea was to utilize unused living spaces to provide affordable stays and local experiences for travelers.

## **Business Model**

Airbnb operates as a platform connecting hosts and guests and earns commission from both parties for every booking.

## **Reasons for Success**

Airbnb's asset-light model, strong trust and review system, global scalability, and community-based approach helped it grow rapidly across countries.

## **4. Case Study: Facebook**



## **Overview**

Facebook started as a college networking site and gradually became the world's largest social media platform connecting billions of users.

## **Key Idea**

The main idea was to connect people digitally and enable online communities.

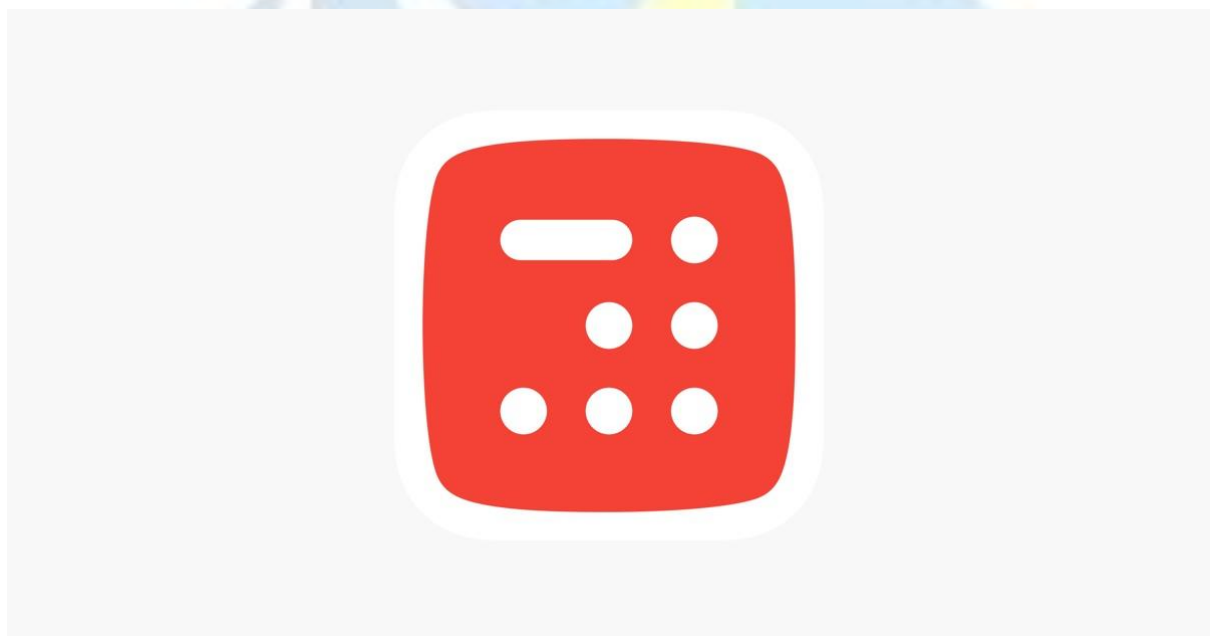
### **Business Model**

Facebook offers a free platform to users and generates revenue primarily through digital advertising.

### **Reasons for Success**

Its strong network effect, continuous innovation, user-friendly interface, and global reach made Facebook a dominant digital platform.

## **5. Case Study: Inshorts**



### **Overview**

Inshorts delivers news summaries in 60 words, targeting mobile users who prefer quick information.

### **Key Idea**

The key idea was to simplify news consumption for busy readers.

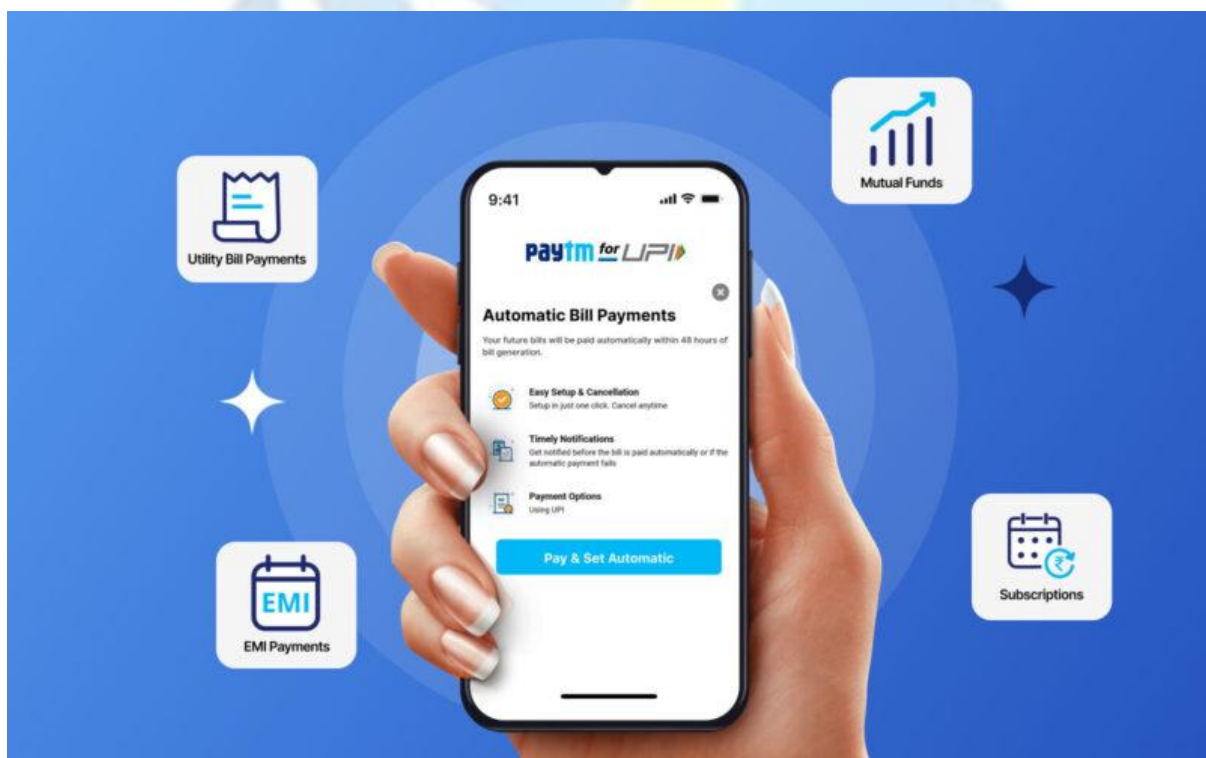
### **Business Model**

Inshorts provides app-based content and earns revenue through advertising and brand partnerships.

### **Reasons for Success**

Its clear content differentiation, mobile-first strategy, strong appeal among youth, and consistent user experience contributed to its success.

## 6. Case Study: Paytm



### Overview

Paytm emerged as a leader in digital payments and financial services in India.

### Key Idea

The main idea was to promote **cashless transactions** using mobile technology.

### Business Model

Paytm offers wallet and UPI payments, merchant services, and financial products such as insurance and loans.

## Reasons for Success

Early market entry, support from government policies like demonetization, wide merchant adoption, and service diversification helped Paytm grow rapidly.

## Key Learnings from Successful Startups

Successful startup cases highlight that problem-solving forms the foundation of entrepreneurship, technology enables scalability, strong teams are more important than ideas alone, customer experience drives growth, and the ability to pivot helps startups survive and succeed.





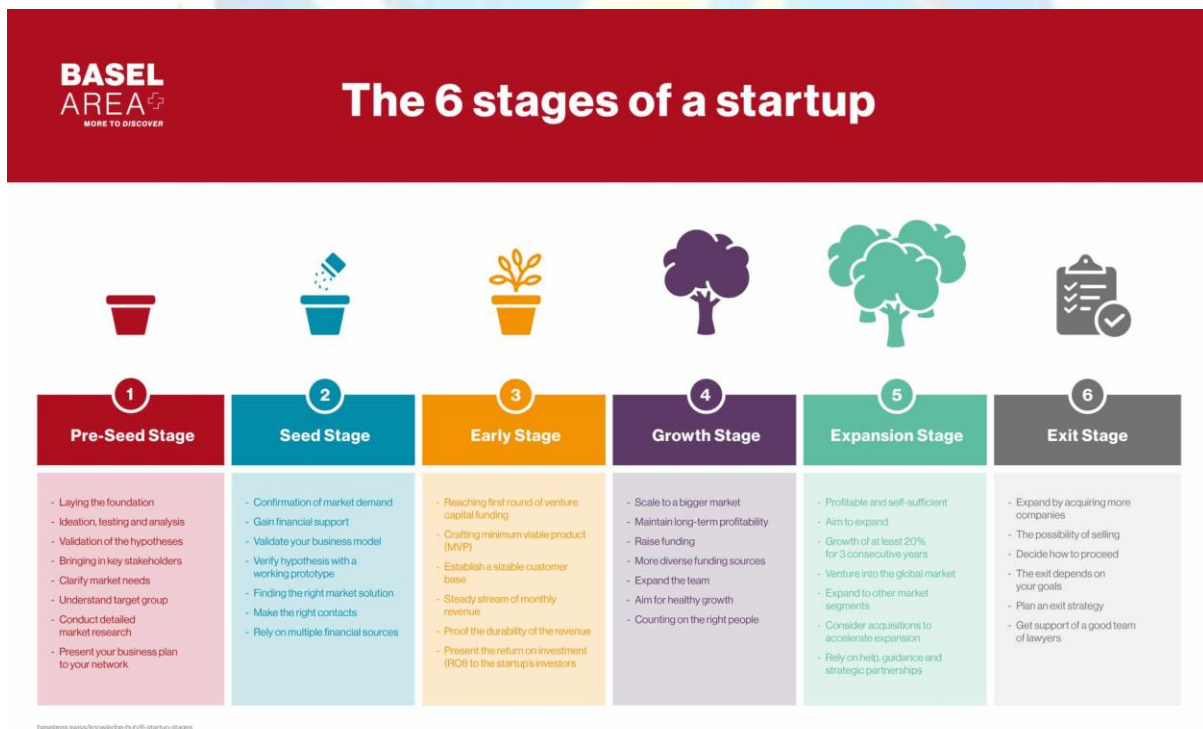
## **Module 4**

विद्या अनन्तम्

## Phases of Start-ups

Understanding the **phases of start-ups** helps students learn how a business idea gradually develops into a mature organization and finally prepares for exit. Similarly, **Design Thinking** is a structured problem-solving approach that supports innovation at every startup stage. Both concepts are explained in detail below in simple and exam-oriented language.

## Phases of Start-ups



### 1. Pre-Company Formation Stage

This is the **idea and planning stage** of a startup. At this phase, the entrepreneur identifies a problem, generates a business idea, and evaluates its feasibility. Market research is conducted to understand customer needs, competitors, and industry trends. The entrepreneur also works on idea validation, initial business model, and value proposition. Activities such as identifying co-founders, basic financial planning, and risk assessment are carried out. No legal business entity is formed at this stage, and the focus remains on testing whether the idea is worth pursuing.

### 2. Startup / Company Formation Stage

In this stage, the startup is **legally formed** and begins formal operations. The business is registered, licenses are obtained, and bank accounts are opened. Founders develop a minimum viable product (MVP) or basic version of the service and launch it in the market. Initial hiring takes place, and early customers are acquired. Funding may come from personal savings, friends and family, angel investors, or seed funding. The main objective of this stage is to achieve product-market fit.

### 3. Development Stage

The development stage focuses on **improving the product and stabilizing operations**. Based on customer feedback, the startup refines its product, service quality, and business processes. Marketing efforts increase, customer base expands, and revenue generation begins. Systems for operations, finance, customer support, and human resources are developed. The startup also works on branding and strengthening its market presence. This stage is critical because poor execution can lead to failure.

### 4. Growth Stage

The growth stage is marked by **rapid expansion and scalability**. The startup experiences increasing sales, customer demand, and market recognition. Expansion may include entering new markets, launching new products, or increasing production capacity. Larger investments such as venture capital funding are often raised during this phase. Management structures become more formal, and focus shifts toward scaling operations efficiently while maintaining quality and customer satisfaction.

### 5. Preparation for Exit Stage

In this final phase, the startup prepares for **exit opportunities**. Exit may occur through acquisition by a larger company, merger, or initial public offering (IPO). Financial records are organized, legal compliance is ensured, and valuation is maximized. Founders and investors plan their exit strategy to realize returns on investment. Some startups may choose long-term sustainability instead of exit, but planning for exit remains important for strategic decision-making.

## Design Thinking

Design Thinking is a **human-centered, problem-solving approach** that helps startups develop innovative solutions by focusing on user needs. It consists of five interconnected stages:

## Design Thinking



Empathize



Define



Ideate



Prototype



Test



## 1. Empathise

In this stage, entrepreneurs understand users by observing, engaging, and interacting with them. The goal is to identify customer pain points, emotions, needs, and expectations. Empathy helps startups design solutions that truly address real-world problems.

## 2. Define (the Problem)

Here, the insights gathered during the empathy stage are analyzed to clearly define the core problem. The problem statement is framed in a user-centric manner. A well-defined problem ensures that the startup focuses on solving the right issue.

## 3. Ideate

In the ideation stage, creative ideas are generated to solve the defined problem. Brainstorming, mind mapping, and creative thinking techniques are used. The focus is on generating multiple solutions without immediate judgment.

## 4. Prototype

A prototype is a **basic and low-cost version** of the product or solution. It allows startups to visualize ideas and test functionality. Prototyping helps in identifying design flaws and improving solutions before full-scale production.

## 5. Test

In the testing stage, prototypes are tested with real users to gather feedback. The startup learns what works and what does not. Based on feedback, improvements are made, and sometimes the process returns to earlier stages. Testing ensures continuous improvement and reduces the risk of failure.



# **GOKUL GLOBAL UNIVERSITY**

Faculty of Commerce & Management

E-Content



<b>Course:</b>	Bachelor of Business Administration
<b>Semester:</b>	03
<b>Subject:</b>	Corporate Accounting
<b>Subject Code:</b>	FMB230106

**Address:** -Gokul Global University, SujanpurPatia, Opp.  
I.O.C. Depot. State Highway- 41, Siddhpur-384151, Gujarat

**Prepared By:** Dr. Ashabahen J Rabari

## Program Details

**Program:** Bachelor of Business Administration (BBA)

**Subject / Branch:** Management

**Year:** 2nd Year

**Semester:** 3rd Semester

## Course Information

**Course Title:** Corporate Accounting

**Course Code:** FMB230106

**Course Type:** Core Compulsory

**Course Credit:** 04

### Pre-Requisite:

10+2 (Commerce) from a recognized education board.

## Rationale of the Course

The course is designed to familiarize students with the concepts of corporate accounting and their practical application in business organizations. It aims to develop an understanding of accounting treatments related to companies and to build analytical skills required for corporate financial decision-making.

## Teaching and Examination Scheme

Teaching (Hours / Week)	Examination Scheme	Marks Distribution
Lecture: 4	Internal Assessment	20
Tutorial: 0	Mid Semester (CE)	10
Practical: 0	External Examination	70
	<b>Total</b>	<b>100</b>

## Course Objectives

1. To explain the characteristics and legal structure of corporations.
2. To differentiate between various forms of business entities such as sole proprietorship, partnership, and corporation.
3. To understand the issue and accounting treatment of different types of shares.

## Course Outcomes

After successful completion of the course, students will be able to:

1. Understand and prepare company final accounts.
2. Acquire knowledge regarding the concept and valuation of goodwill.
3. Gain an understanding of internal reconstruction of companies.
4. Apply the double-entry accounting system ensuring equal and opposite effects of transactions.

## Course Content and Unit-wise Distribution

### Unit I – Valuation of Goodwill

**Credit Weightage:** 1

**Marks Weightage:** 25%

This unit covers the meaning of goodwill and its importance in business. It explains provisions relating to goodwill under various accounting standards and the need for valuation of goodwill. The unit includes methods of valuation such as arbitrary assessment, average profit method (simple average, weighted average, annuity method), super profit method, and capitalization of profit method using both average profit and super profit approaches.

### Unit II – Valuation of Shares

**Credit Weightage:** 1

**Marks Weightage:** 25%

This unit explains the circumstances requiring valuation of shares and factors affecting share valuation. It covers methods of valuation of shares, valuation of fully paid-up and partly paid-up equity shares and preference shares under the net assets method, valuation of equity shares under the yield method, and fair value of shares. The unit also includes valuation of right shares and bonus shares.

### Unit III – Bank Accounts

**Credit Weightage:** 1

**Marks Weightage:** 25%

This unit focuses on legal provisions relating to bank accounts on a conceptual basis. It includes an overview of the **Banking Regulation Act, 1949**, business activities carried on by banks, non-banking assets and their disposal, management of banks, share capital, creation of floating charge on properties, statutory reserves, cash reserve ratio and statutory liquidity ratio, restrictions on acquisition of shares in other companies, restrictions on loans and advances, and non-performing assets (NPA). The unit also covers preparation of final accounts of banks.

**Note:**

Only simple adjustments will be asked. Either the Income Statement or the Balance Sheet

with relevant schedules will be asked. Combined questions on final accounts will not be asked.

## **Unit IV – Liquidation of Company**

**Credit Weightage:** 1

**Marks Weightage:** 25%

This unit explains the meaning of liquidation and winding up on a conceptual basis. It includes methods of liquidation, compulsory winding up by the National Company Law Tribunal, voluntary winding up, and consequences of winding up. The unit further covers preferential payments, overriding preferential payments under Section 529A of the Companies (Amendment) Act, 1985, powers and duties of liquidators, order of disbursement of assets as per latest statutory provisions, and preparation of liquidator's final statement of account as per current statutory requirements.

### **Reference Books**

1. K. L. Shah – *Corporate Accounting (Theory & Practice)*, Shree Niwas Publishing
2. Dr. S. N. Maheshwari & S. K. Maheshwari – *Corporate Accounting*, Vikas Publishing House

### **Suggested Readings**

1. J. R. Monga – *Basic Corporate Accounting*, Mayur Paperbacks, New Delhi
2. Nirmal Gupta & Chhavi Sharma – *Corporate Accounting: Theory and Practice*, Ane Books Pvt. Ltd.
3. M. C. Shukla, T. S. Grewal & S. C. Gupta – *Corporate Accounting*, S. Chand & Co., New Delhi

### **Online Resources**

1. [www.pdfdrive.com](http://www.pdfdrive.com)
2. [www.slideshare.net](http://www.slideshare.net)

### **Practical / Learning Activities**

1. Online quizzes using Google Forms or similar platforms
2. Breakout room activities focusing on numerical problem-solving and discussion



## **MODULE 1**

विद्या अनन्तम्

## Meaning of Goodwill

Goodwill refers to the **good reputation and market standing** of a business that enables it to earn **higher profits than other firms** in the same line of business. It arises due to factors such as customer satisfaction, quality products, efficient management, favourable location, and strong brand image.

Although goodwill **cannot be seen or touched**, it has a real monetary value. Therefore, it is treated as an **intangible asset** and is recognised only when it is acquired for consideration.

### Definitions of Goodwill

- **Lord Lindley:**  
*“Goodwill represents the advantage of a good name, reputation, and connection of a business.”*
- **Spicer and Pegler:**  
*“Goodwill is the benefit arising from reputation and connections that allow a business to earn profits above the normal return on capital.”*

## Accounting Treatment of Goodwill

According to **Accounting Standard (AS)-26**, goodwill is recorded in books **only when it is purchased** for money or money's worth.

### Key Rules:

1. **Purchased Goodwill**
  - Recorded in books.
  - Usually written off immediately or over a period.
2. **Internally Generated Goodwill**
  - Not recorded in books.
  - Arises during admission, retirement, death of a partner, or change in profit-sharing ratio.

### Adjustment of Goodwill among Partners

When the profit-sharing ratio changes:

- **Gaining partner compensates the sacrificing partner**
- Adjustment is made through **Capital or Current Accounts**

### Formula:

$$\left[ \text{Compensation} = \text{Value of Goodwill} \times \text{Share Gained} \right]$$

### Illustration

A and B share profits in the ratio 3:2. They agree to share profits equally.

Goodwill = ₹60,000

- A sacrifices =  $\frac{1}{10}$
- B gains =  $\frac{1}{10}$

**Compensation payable by B to A:**

$$\left[ 60,000 \times \frac{1}{10} = ₹6,000 \right]$$

## Methods of Valuation of Goodwill

There are **three main methods**:

1. Average Profit Method
2. Super Profit Method
3. Capitalisation Method

### 1. Average Profit Method

Under this method, goodwill is valued on the basis of **average past profits** of the firm.

**Adjustments Required:**

- Abnormal profits → deducted
- Abnormal losses → added back
- Non-business income → deducted

**(A) Simple Average Profit Method**

**Formula:**

$$\left[ \text{Average Profit} = \frac{\text{Total Adjusted Profits}}{\text{Number of Years}} \right]$$

$$\left[ \text{Goodwill} = \text{Average Profit} \times \text{Years of Purchase} \right]$$

**Example**

Profits:

- 2019: ₹80,000 (includes abnormal gain ₹10,000)
- 2020: ₹1,00,000 (after abnormal loss ₹20,000)
- 2021: ₹90,000

Adjusted total profit = ₹2,80,000

$$\left[ \begin{array}{l} \text{Average Profit} = \frac{2,80,000}{3} = ₹93,334 \end{array} \right]$$

Goodwill for 2 years:

$$\left[ \begin{array}{l} 93,334 \times 2 = ₹1,86,668 \end{array} \right]$$

### **(B) Weighted Average Profit Method**

More weight is given to **recent years' profits**, making this method more realistic.

#### **Steps:**

1. Assign weights to profits
2. Multiply profit with respective weight
3. Divide total weighted profit by total weights
4. Multiply by years of purchase

#### **Formula:**

$$\left[ \begin{array}{l} \text{Weighted Average Profit} = \frac{\text{Total Weighted Profits}}{\text{Total Weights}} \end{array} \right]$$

$$\left[ \begin{array}{l} \text{Goodwill} = \text{Weighted Average Profit} \times \text{Years of Purchase} \end{array} \right]$$

#### **Example**

Weighted Average Profit = ₹32,800

Years of purchase = 2

$$\left[ \begin{array}{l} \text{Goodwill} = 32,800 \times 2 = ₹65,600 \end{array} \right]$$

## **2. Super Profit Method**

Super profit is the **excess of actual profit over normal profit**.

#### **Formulae:**

$$\text{Normal Profit} = \frac{\text{Capital Employed} \times \text{Normal Rate}}{100}$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$$

$$\text{Goodwill} = \text{Super Profit} \times \text{Years of Purchase}$$

### Example

Capital employed = ₹6,00,000

Normal rate = 10%

Average profit = ₹75,000

Normal Profit = ₹60,000

Super Profit = ₹15,000

Goodwill for 2.5 years:

$$15,000 \times 2.5 = ₹37,500$$

## Difference Between Average Profit and Super Profit Method

Basis	Average Profit Method	Super Profit Method
Basis of valuation	Average profit	Excess profit
Complexity	Simple	More complex
Normal return	Not considered	Considered
Accuracy	Less accurate	More accurate
Formula	Total profit ÷ years	Avg. profit – normal profit

## 3. Capitalisation Method

This method calculates goodwill by comparing **capital required to earn profits** with actual capital employed.

### (A) Capitalisation of Average Profit Method

**Formula:**

$$\text{Capitalised Value} = \frac{\text{Average Profit} \times 100}{\text{Normal Rate}}$$

$$\text{Goodwill} = \text{Capitalised Value} - \text{Net Assets}$$

**Example**

Average profit = ₹36,000  
Normal rate = 10%  
Net assets = ₹2,85,000

Capitalised value = ₹3,60,000

Goodwill:

$$3,60,000 - 2,85,000 = ₹75,000$$

**(B) Capitalisation of Super Profit Method**

Here, goodwill equals **capitalised value of super profit.**

**Formula:**

$$\text{Goodwill} = \frac{\text{Super Profit} \times 100}{\text{Normal Rate}}$$

**Example**

Super Profit = ₹30,000  
Normal Rate = 20%

$$\text{Goodwill} = \frac{30,000 \times 100}{20} = ₹1,50,000$$

**Journal Entries for Goodwill Adjustment****Fixed Capital Method**

- Gaining Partner's Capital A/c → Dr
- Sacrificing Partner's Capital A/c → Cr

## Fluctuating Capital Method

- Gaining Partner's Capital A/c → Dr
- Sacrificing Partner's Capital A/c → Cr

## Final Illustration

Ram and Sham share profits in the ratio 3:2. They decide to share profits equally.  
Goodwill = \$50,000

Sacrifice by Ram =  $\frac{1}{10}$   
Gain by Sham =  $\frac{1}{10}$

### Compensation payable:

$$\left[ 50,000 \times \frac{1}{10} = \$5,000 \right]$$

### Journal Entry:

Sham's Capital A/c   Dr   \$5,000  
    To Ram's Capital A/c   \$5,000





## MODULE 2

विद्या अनन्तम्

## **1. Meaning of Valuation of Shares**

Valuation of shares refers to the process of determining the fair or intrinsic value of a company's shares. The market price of shares often fluctuates due to speculation, investor sentiment, and demand–supply conditions. Therefore, the market price may not always reflect the real worth of a share. Valuation helps in estimating the true value based on the company's financial position, profitability, earning capacity, and future prospects. It provides a scientific and logical basis for decision-making in financial and legal matters.

## **2. Circumstances of Valuation of Shares**

### **Admission of a New Partner**

When a firm holding shares admits a new partner, valuation of shares becomes necessary to determine the correct value of existing investments. This ensures that the new partner is charged fairly and existing partners' interests are protected.

### **Purchase or Sale of Shares**

Valuation is essential when shares are bought or sold, especially in private companies where market prices are not available. It helps both buyers and sellers arrive at a fair price and avoid disputes.

### **Amalgamation or Reconstruction of Companies**

During amalgamation or reconstruction, shares of one company are exchanged for shares of another. Valuation is required to determine the exchange ratio so that shareholders of both companies are treated equitably.

### **Conversion of a Private Company into a Public Company**

When a private company is converted into a public company, shares must be valued to fix an appropriate issue price. This ensures transparency and fairness to new investors.

### **Issue of Right Shares or Bonus Shares**

Valuation helps in deciding the correct price at which right shares should be offered and in determining the value of bonus shares. This protects shareholders from dilution of value.

### **Assessment of Wealth Tax, Gift Tax, or Estate Duty**

Tax authorities require valuation of shares to compute tax liabilities accurately. Proper valuation ensures compliance with tax laws and avoids legal complications.

### **Settlement of Disputes among Shareholders**

In cases of disputes such as retirement, death, or separation of shareholders, valuation is necessary to determine the amount payable to the concerned party. It ensures a fair and peaceful settlement.

## **3. Factors Affecting Valuation of Shares**

### **Earning Capacity of the Company**

The earning capacity of a company plays a crucial role in determining the value of its shares.

Companies with stable and high profits generally have higher share values because investors expect better returns.

### **Dividend-Paying Ability**

Regular and higher dividends increase the attractiveness of shares. A company with a consistent dividend policy is valued more than a company with irregular or low dividend payments.

### **Net Assets and Financial Position**

The value of a company's assets after deducting liabilities reflects its financial strength. A strong balance sheet with high net assets increases the intrinsic value of shares.

### **Market Conditions and Demand for Shares**

General market conditions such as economic stability, inflation, interest rates, and investor confidence affect share valuation. Higher demand for shares usually leads to higher valuation.

### **Nature of Business and Future Growth Prospects**

Companies operating in growing industries with good future prospects tend to have higher share values. Stable businesses with innovative products and expansion plans attract more investors.

### **Prevailing Rate of Return in the Market**

If the market rate of return is high, investors expect higher earnings, which may reduce the value of existing shares. Conversely, lower market returns increase share value.

### **Type of Shares (Equity or Preference)**

Equity shares generally carry higher risk and potential returns, while preference shares provide fixed returns. Therefore, the type of share significantly influences its valuation.

## **4. Methods of Valuation of Shares**

Valuation of shares can be done using different methods depending on the purpose, nature of the company, and availability of information. The commonly used methods are explained below.

### **1. Net Assets Method (Intrinsic Value Method)**

Under this method, the value of shares is calculated on the basis of the company's net assets. Net assets represent the excess of total assets over total external liabilities. This method reflects the real worth of the company based on its balance sheet position.

#### **Steps Involved**

1. Find the total value of assets at fair or market value.
2. Deduct external liabilities such as creditors and debentures.
3. The balance represents net assets available for shareholders.
4. Divide net assets by the number of equity shares to get value per share.

#### **Example**

Total assets of a company = ₹10,00,000

External liabilities = ₹4,00,000

Number of equity shares = 6,000

Net assets = ₹10,00,000 – ₹4,00,000 = ₹6,00,000

Value per share = ₹6,00,000 ÷ 6,000 = **₹100 per share**

This method is suitable for companies with strong asset backing.

## 2. Yield (Earnings) Method

The yield method values shares based on the earning capacity of the company. Investors are mainly interested in returns, so this method considers maintainable profits and the normal rate of return in the market.

### Formula

Value per share =  $\frac{\text{Expected earnings per share} \times 100}{\text{Normal rate of return}}$   
Value per share =  $\frac{\text{Expected earnings per share} \times 100}{\text{Normal rate of return}}$

### Example

Maintainable profit = ₹1,50,000

Number of equity shares = 10,000

Normal rate of return = 10%

Earnings per share = ₹1,50,000 ÷ 10,000 = ₹15

Value per share = (₹15 × 100) ÷ 10 = **₹150 per share**

This method is ideal for profit-earning and dividend-paying companies.

## 3. Fair Value Method

The fair value method is a combination of the **Net Assets Method** and the **Yield Method**. It provides a balanced value by considering both asset strength and earning capacity.

### Formula

Fair Value per share =  $\frac{\text{Intrinsic value} + \text{Yield value}}{2}$   
Fair Value per share =  $\frac{\text{Intrinsic value} + \text{Yield value}}{2}$

### Example

Value per share under Net Assets Method = ₹120

Value per share under Yield Method = ₹180

Fair value per share =  $(₹120 + ₹180) \div 2 = \mathbf{₹150 \text{ per share}}$

This method is widely used in practice because it gives a reasonable and fair valuation.

## 4. Valuation of Right Shares

Right shares are offered to existing shareholders at a price lower than the market price to raise additional capital. Valuation of right shares helps in determining the value of the right.

### Formula

Value of right = Market value –

$$\frac{\text{Market value} - \text{Issue price}}{\text{Number of old shares required to buy one new share}}$$
  
Value of right =  $\frac{\text{Market value} - \text{Issue price}}{\text{Number of old shares required to buy one new share}}$

### Example

Market value of a share = ₹150

Right issue price = ₹120

Right offered = 1 share for every 4 shares held

Value of right =  $(₹150 - ₹120) \div 4 = \mathbf{₹7.50 \text{ per share}}$

This represents the benefit given to existing shareholders.

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## 5. Valuation of Bonus Shares

Bonus shares are issued free of cost to existing shareholders by capitalizing reserves. Although shareholders do not pay anything, the market value of shares changes after the bonus issue.

### Example

Market price before bonus = ₹200

Bonus issue = 1:1

After bonus, number of shares doubles, so the value per share reduces.

Revised value per share =  $₹200 \div 2 = \mathbf{₹100 \text{ per share}}$

Although the price per share falls, the total value of investment remains the same.

## 5. Net Assets Method

Under this method, shares are valued on the basis of the **net assets of the company**.

### Formula:

$$\text{Value per Share} = \frac{\text{Net Assets}}{\text{Number of Equity Shares}}$$

Where,

$$\text{Net Assets} = \text{Total Assets} - \text{External Liabilities}$$

### Illustration 1: Valuation of Fully Paid-up Equity Shares

#### Given:

- Total Assets = ₹9,00,000
- External Liabilities = ₹3,00,000
- Number of Equity Shares = 6,000

#### Solution:

$$\text{Net Assets} = 9,00,000 - 3,00,000 = ₹6,00,000$$

$$\text{Value per Share} = \frac{6,00,000}{6,000} = ₹100$$

$$\text{Value of one equity share} = ₹100$$

### Illustration 2: Valuation of Partly Paid-up Equity Shares

- Value of fully paid share = ₹100
- Paid-up value = ₹80

#### Solution:

$$\text{Value of partly paid share} = \frac{80}{100} \times 100 = ₹80$$

## 6. Yield (Earnings) Method

Under this method, shares are valued on the basis of **earning capacity** or **dividend yield**.

### Formula:

Value per Share =  $\frac{\text{Dividend per Share} \times 100}{\text{Normal Rate of Return}}$   
 $\text{Value per Share} = \frac{\text{Dividend per Share} \times 100}{\text{Normal Rate of Return}}$

### Illustration 3: Fully Paid-up Equity Shares (Yield Method)

**Given:**

- Dividend per share = ₹15
- Normal rate of return = 12%

**Solution:**

Value per Share =  $\frac{15 \times 100}{12} = ₹125$   
 $\text{Value per Share} = \frac{15 \times 100}{12} = ₹125$

### Illustration 4: Partly Paid-up Equity Shares (Yield Method)

**Given:**

- Dividend on fully paid share = ₹12
- Paid-up value = ₹75
- Face value = ₹100
- Normal rate = 10%

**Step 1: Adjust dividend**

Adjusted Dividend =  $12 \times \frac{75}{100} = ₹9$   
 $\text{Adjusted Dividend} = 12 \times \frac{75}{100} = ₹9$

**Step 2: Valuation**

Value per Share =  $\frac{9 \times 100}{10} = ₹90$   
 $\text{Value per Share} = \frac{9 \times 100}{10} = ₹90$

## 7. Fair Value Method

The fair value method considers both **financial strength and earning capacity**.

**Formula:**

Fair Value =  $\frac{\text{Net Assets Value} + \text{Yield Value}}{2}$   
 $\text{Fair Value} = \frac{\text{Net Assets Value} + \text{Yield Value}}{2}$

### Illustration 5: Fair Value of Equity Shares

- Net Assets Value = ₹140
- Yield Value = ₹120

**Solution:**

$$\text{Fair Value} = \frac{140 + 120}{2} = ₹130$$

## 8. Valuation of Right Shares

Right shares are offered to existing shareholders at a price **below market value**.

**Formula:**

$$\text{Value of Right} = \frac{\text{Market Price} - \text{Issue Price}}{\text{Old Shares} + \text{New Shares}}$$

**Illustration 6: Valuation of Right Shares****Given:**

- Market price = ₹150
- Issue price = ₹120
- Rights issue = 1 share for every 4 shares held

**Solution:**

$$\text{Value of Right} = \frac{150 - 120}{4 + 1} = ₹6$$

**Value of one right = ₹6**

## 9. Valuation of Bonus Shares

Bonus shares are issued **free of cost** to existing shareholders. They reduce the market price per share but do not affect total wealth.

**Formula:**

$$\text{Value after Bonus} = \frac{\text{Market Price} \times \text{Old Shares}}{\text{Total Shares after Bonus}}$$

**Illustration 7: Valuation of Bonus Shares****Given:**

- Market price = ₹200
- Bonus issue = 1 share for every 4 shares

**Solution:**

Value after Bonus =  $200 \times 45 = ₹160$   
 $\text{Value after Bonus} = \frac{200 \times 4}{5} = ₹160$   
Value after Bonus =  $5200 \times 4 = ₹160$

**Market value per share after bonus = ₹160**





## **MODULE 3**

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## Bank Accounts – Legal Provisions (Concepts Only)

Bank accounting in India is mainly governed by the **Banking Regulation Act, 1949**. This Act lays down detailed rules relating to the functioning, control, management, and financial reporting of banks. The objective of these legal provisions is to ensure the safety of depositors' money, promote sound banking practices, and maintain stability in the banking system.

### 1. Banking Regulation Act, 1949 – Meaning and Scope

The Banking Regulation Act, 1949 is a special legislation enacted to regulate banking companies operating in India. It defines the meaning of banking, specifies permissible banking activities, and prescribes rules regarding management, capital, reserves, and accounts of banks. The Act applies to all banking companies in India and gives extensive powers to the **Reserve Bank of India** to supervise, inspect, and control banks in the public interest.

### 2. Business Carried on by Banks

Under the Act, banks are permitted to carry on activities that are closely connected with banking. These include accepting deposits from the public for lending or investment purposes, granting loans and advances in various forms such as overdrafts and cash credits, and discounting bills of exchange and promissory notes. Banks are also allowed to deal in foreign exchange, issue letters of credit and bank guarantees, act as agents or trustees for customers, and provide safe custody services. These activities help banks earn income mainly through interest and service charges.

### 3. Non-Banking Assets and Their Disposal

Non-banking assets are assets acquired by banks in satisfaction of claims, such as immovable property taken over from borrowers who fail to repay loans. Banks are not permitted to hold such assets permanently, as they are not part of normal banking business. According to the Act, non-banking assets must generally be disposed of within a period of seven years. This provision prevents banks from engaging in trading or real estate activities and ensures that their resources remain focused on core banking operations. In special cases, extension of time requires RBI approval.

### 4. Management of Banks

The Banking Regulation Act contains several provisions relating to the management of banks to ensure efficiency, integrity, and public confidence. It provides guidelines for the appointment of qualified directors and restricts individuals from holding key positions in multiple banking companies simultaneously. The Act empowers the RBI to remove directors or appoint additional directors when necessary to protect the interests of depositors. Proper management and governance are essential for maintaining trust in the banking system.

### 5. Share Capital of Banks

Banks are required to maintain adequate share capital as prescribed under the Act. Share capital represents the owners' contribution and acts as a financial cushion against losses. The capital structure of a bank must comply with regulatory norms, and any issue or reduction of share capital requires prior approval from the RBI. Adequate capital ensures solvency, financial strength, and long-term stability of banks.

## 6. Creation of Floating Charge on Properties

The Act restricts banks from creating floating charges on their properties without obtaining prior permission from the RBI. A floating charge is a charge on assets that change from time to time, such as stock-in-trade or receivables. This restriction safeguards depositors' interests, prevents misuse of bank assets, and ensures regulatory control over major financial decisions taken by banks.

## 7. Statutory Reserves

Banks are required to transfer a specified portion of their profits to statutory reserves before declaring dividends. These reserves are created out of profits and are meant to strengthen the financial position of banks. Statutory reserves help banks absorb future losses and act as a measure of financial discipline, thereby improving long-term stability.

## 8. Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

The Cash Reserve Ratio (CRR) refers to the portion of total deposits that banks must keep as cash with the RBI. This requirement helps control inflation, ensures liquidity, and supports monetary stability. The Statutory Liquidity Ratio (SLR) requires banks to maintain a certain percentage of their deposits in liquid assets such as government securities, treasury bills, and gold. SLR ensures that banks always have sufficient liquid funds to meet their obligations.

### Cash Reserve Ratio (CRR) – Formula

$$\text{CRR} = \frac{\text{Cash Reserves with RBI}}{\text{Total Demand and Time Liabilities}} \times 100$$

$$\text{CRR} = \frac{\text{Cash Reserves with RBI}}{\text{Total Demand and Time Liabilities}} \times 100$$

### Explanation

Cash Reserve Ratio represents the percentage of a bank's total deposits that must be kept **in cash with the Reserve Bank of India**. Banks cannot use this money for lending or investment purposes.

### Statutory Liquidity Ratio (SLR) – Formula

$$\text{SLR} = \frac{\text{Liquid Assets}}{\text{Total Demand and Time Liabilities}} \times 100$$

$$\text{SLR} = \frac{\text{Liquid Assets}}{\text{Total Demand and Time Liabilities}} \times 100$$

## Explanation

Statutory Liquidity Ratio represents the percentage of total deposits that banks must maintain in the form of **liquid assets** such as cash, gold, and approved government securities.

## 9. Restriction on Acquisition of Shares in Other Companies

Banks are subject to restrictions on acquiring shares in other companies beyond specified limits. These restrictions are intended to prevent speculative investments and reduce financial risk. By limiting such investments, the Act ensures that banks concentrate on their core banking activities. In many cases, prior approval of the RBI is required for acquiring substantial shareholdings.

## 10. Restriction on Loans and Advances

The Act imposes various restrictions on the granting of loans and advances by banks to prevent misuse of funds and conflicts of interest. Loans to directors and related parties are either restricted or closely regulated. Banks are prohibited from granting advances against their own shares, and large loans are subject to exposure limits prescribed by the RBI. These provisions help reduce the risk of fraud, favoritism, and bad debts.

## 11. Non-Performing Assets (NPA)

A loan or advance becomes a Non-Performing Asset (NPA) when interest or principal remains overdue for more than ninety days. NPAs are classified into sub-standard assets, doubtful assets, and loss assets based on the period of default and recoverability. High levels of NPAs adversely affect bank profitability and financial health. Therefore, banks are required to make adequate provisions for NPAs in accordance with RBI guidelines.

## Illustration 1: Profit & Loss Account of a Bank

### Trial Balance Extracts (as on 31-03-2023)

Particulars	Amount (₹)
Interest on Advances	6,00,000
Interest on Investments	1,50,000
Commission & Brokerage	75,000

Interest on Deposits	4,00,000
Salaries	90,000
Rent & Taxes	40,000
Printing & Stationery	25,000
Depreciation on Fixed Assets	20,000

### Adjustments

1. Provide ₹30,000 for NPAs
2. Outstanding salaries ₹10,000

### Step 1: Classification of Items

#### Income

- Interest on Advances
- Interest on Investments
- Commission & Brokerage

#### Expenditure

- Interest on Deposits
- Salaries (adjusted)
- Rent & Taxes
- Printing & Stationery
- Depreciation
- Provision for NPAs

### Step 2: Adjustments Calculation

#### Salaries

$$= 90,000 + 10,000$$

$$= \mathbf{₹1,00,000}$$

Profit & Loss Account for the year ended 31-03-2023

Particulars	Amount (₹)
Interest Earned (Sch. 13)	
– Interest on Advances	6,00,000

– Interest on Investments	1,50,000
Other Income (Sch. 14)	
– Commission & Brokerage	75,000
<b>Total Income</b>	<b>8,25,000</b>

Particulars	Amount (₹)
Interest Expended (Sch. 15)	
– Interest on Deposits	4,00,000
Operating Expenses (Sch. 16)	
– Salaries	1,00,000
– Rent & Taxes	40,000
– Printing & Stationery	25,000
– Depreciation	20,000
<b>Total Expenditure</b>	<b>5,85,000</b>

### Operating Profit

$$= 8,25,000 - 5,85,000$$

$$= ₹2,40,000$$

Less: Provision for NPAs = 30,000

### Net Profit

$$= ₹2,10,000$$

## Illustration 2: Balance Sheet of a Bank

Given Information (as on 31-03-2024)

Particulars	Amount (₹)
Paid-up Capital	10,00,000
Statutory Reserve	2,00,000
Deposits	25,00,000
Borrowings	3,00,000
Cash in Hand	1,20,000
Balance with RBI	3,80,000
Investments	12,00,000
Advances	18,00,000
Fixed Assets	2,50,000

### Adjustment

Provision for NPAs ₹50,000

### Step 1: Treatment of Adjustment

Provision for NPAs will appear under:

**Other Liabilities and Provisions**

#### Balance Sheet as on 31-03-2024

CAPITAL & LIABILITIES		ASSETS	
Particulars	Amount (₹)	Particulars	Amount (₹)
Capital (Sch. 1)	10,00,000	Cash & Balances with RBI (Sch. 6)	
Reserves & Surplus (Sch. 2)	2,00,000	– Cash in hand	1,20,000
Deposits (Sch. 3)	25,00,000	– Bal/ance with RBI	3,80,000
Borrowings (Sch. 4)	3,00,000	Investments (Sch. 8)	12,00,000
Other Liabilities & Provisions (Sch. 5)		Advances (Sch. 9)	18,00,000
– Provision for NPAs	50,000	Fixed Assets (Sch. 10)	2,50,000
<b>Total</b>	<b>40,50,000</b>	<b>Total</b>	<b>40,50,000</b>



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## **MODULE 4**

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## Liquidation of Company

### 1. Meaning of Liquidation and Winding Up

Liquidation and winding up refer to the legal process through which a company is brought to an end and its existence as a legal entity is terminated. Though the terms are often used together, they are not exactly the same. Winding up is the overall legal process that begins when a company decides or is ordered to close its business, while liquidation is the practical stage of winding up.

During liquidation, the assets of the company are realized, liabilities are paid off, and any surplus remaining is distributed among shareholders. The primary purpose of liquidation is to ensure an orderly settlement of the company's affairs under the supervision of law so that the interests of creditors, employees, and shareholders are protected.

### 2. Methods of Liquidation (Concepts Only)

The law provides different methods for liquidating a company depending on the situation in which the company finds itself. These methods are designed to ensure fairness, legality, and transparency in the closure of business.

Broadly, liquidation may take place either through compulsory winding up ordered by a legal authority or through voluntary winding up initiated by the company itself. Each method follows specific legal procedures and safeguards to protect stakeholders such as creditors, employees, and shareholders.

### 3. Compulsory Winding Up by National Company Law Tribunal (NCLT)

Compulsory winding up takes place when a company is ordered to be wound up by the **National Company Law Tribunal**. This form of winding up usually occurs when the company is unable to pay its debts, has engaged in fraudulent or unlawful activities, has acted against national or public interest, or when it is just and equitable to wind up the company. Once the Tribunal issues the winding-up order, the company's management loses control over its affairs, and an official liquidator is appointed.

The liquidator takes custody of the company's assets and carries out liquidation strictly under the Tribunal's supervision, ensuring compliance with legal provisions.

### 4. Voluntary Winding Up

Voluntary winding up occurs when a company decides on its own to wind up its operations. This decision may arise when the company has achieved its objectives, completed its project, or is no longer profitable. In voluntary winding up, the shareholders or creditors pass a formal resolution to dissolve the company. A liquidator is appointed to take charge of the company's assets, realize them, and settle liabilities. Although the process is voluntary, it must still

follow statutory rules to ensure that the interests of creditors and shareholders are not adversely affected and that the winding-up process remains fair and transparent.

## **5. Consequences of Winding Up (Concepts Only)**

Once the winding-up process begins, several important legal consequences follow. The company ceases to carry on business activities except those required for beneficial liquidation. The powers of directors automatically come to an end, and the control of the company's affairs passes to the liquidator.

Legal proceedings against the company cannot be initiated or continued without the permission of the Tribunal. The assets of the company are collected and liabilities are settled according to statutory priority. Finally, after completion of liquidation, the company is dissolved and ceases to exist as a legal entity.

## **6. Preferential Payments**

Preferential payments are certain debts that are given priority over ordinary unsecured creditors during liquidation. These payments are made before settling the claims of general creditors because of their social and legal importance. Preferential payments generally include government taxes, employee wages, and certain statutory dues.

The objective of preferential payments is to ensure that essential claims, particularly those affecting employees and public revenue, are satisfied before distributing the remaining assets among other creditors.

## **7. Overriding Preferential Payments under Section 529A**

Section 529A of the Companies Act, introduced by the Companies (Amendment) Act, 1985, provides for overriding preferential payments. These payments take priority over all other claims, including secured creditors.

The most important overriding preferential payments are workmen's dues and secured creditors' dues to the extent they rank equally with workmen's dues. This provision was introduced to safeguard the interests of workers and ensure that employees are not deprived of their rightful dues when a company is liquidated.

## **8. Powers and Duties of Liquidators**

The liquidator is a legally appointed authority responsible for conducting the liquidation process. The liquidator has wide powers, including taking possession of company assets, selling properties, recovering outstanding debts, and representing the company in legal proceedings. Along with these powers, the liquidator has important duties such as maintaining proper books of accounts, preparing statements of receipts and payments, and distributing funds according to statutory order.

The liquidator must act honestly, impartially, and with due care to protect the interests of creditors and shareholders.

## **9. Order of Disbursement by Liquidator (As per Latest Statutory Revision)**

The liquidator must distribute the realized funds strictly in the order prescribed by law. First, the expenses and costs of liquidation are paid. Next, overriding preferential payments under Section 529A, including workmen's dues and secured creditors' claims, are settled. Thereafter, preferential creditors are paid.

If any balance remains, secured creditors are paid, followed by unsecured creditors. Any surplus remaining after settling all liabilities is distributed among preference shareholders, and finally among equity shareholders. This statutory order ensures fairness and legal compliance in the distribution of assets.

## **10. Preparation of Liquidator's Final Statement of Account**

The liquidator is required to prepare a final statement of account at the completion of liquidation. This statement shows all receipts and payments made during the liquidation period, including realization of assets, payment of liabilities, liquidation expenses, and distribution to shareholders.

The final account must be prepared in the prescribed statutory format and submitted to the Tribunal or Registrar for approval. This statement ensures transparency, accountability, and proper closure of the liquidation process. Once approved, the company is formally dissolved.

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