

MEFA
UNIT-1

* Introduction to MEFA

- Definition of Managerial Economics
- Scope, M-Economics & its relation with other subjects
- Concept of Demand & its types
- Determinants of Law of Demand & its Exceptions
- Elasticity of Demand
- Types of E. of Demand, Measurement.
- Demand Forecasting & its methods.

M. E. F. AManagerial Economics and Financial Analysis

Economics :- Economics is the study of human beings who rationally relate their limited resources with their unlimited wants to get maximum satisfaction.

Management :- Management is the 'art' of getting things done through people.

Managerial Economics is the perfect blend of Mgt & Economics.

Economics is the study of human activities in relation to the production and consumption of goods for the satisfaction of human wants.

Managerial Economics is the integration of economic theory with business practice for the purpose of facilitating "decision making" and "forward planning" by management.

— MANSFIELD

Firstly,

The word 'Economics' is derived from the 'Greek word' Oikos and Nomes which means "Household Mgt."

Adam Smith is the father of Economics.

Before 18th century, Economics meant - the "study of wealth / money". But, it was extended in all aspects, like numerous institutions which engaged in economic activities.

{ The accountant provides accounting information relating to costs, revenues, Receivables, payables, profits / losses etc... and these information makes the managerial Economist to act upon.

The Performance of firm depends upon the Accounting information & Decision making.

Definitions :-

1) "Adam Smith" the father of Economics was defined, "the study of nature & uses of national wealth"

Adam Smith defined Economics as "Science of wealth"
(The founder of Modern Economics)

"Economics is science of wealth which studies that how the wealth is produced, how it is consumed, for whom it is produced and how it is distributed. According to this definition, Economics studies)

- Production of wealth
- Consumption of wealth
- Distribution of wealth

2) Prof. Lionel Robbins

— defined Economics as "The science which studies human behaviour as a relationship b/w ends and scarce means which have alternative uses."
(Wants)

Salient features of Economics according to Prof. Robbins are as follows:-

- 1) Unlimited Wants:- We have unlimited no. of ends/wants and it is difficult to satisfy all these wants.
- 2) Scarce Resources:- We have limited / Scarce resources.
Limited supply → automatically scarcity arises.
So that Economic problem arises.
- 3) Alternative uses:-
Example:- Suppose We have just ₹ 1000 in our pocket.
So, We can use that money for diff. purposes
like → For college fee (or)
→ Visiting a hotel with family (or) alternatives
→ Purchase of Journals
4) Choice:- Of all the above alternatives, which one do I choose?
What alternative satisfy my unlimited wants with the limited / scarce resources.?

In reality, Wants are unlimited, but the resources are limited.

So,

Scarcity is the root cause for the emergence of all Economic problems.

Classification of Economics :-

Economics consists of 2 branches

- Micro Economics
- Macro Economics.

1) Micro Economics :- Study of individual consumer / firm / industry. Micro Economics also called "Theory of firm" (or) "Price theory".
(deals with behaviour & problems of single org / individual / firm)

2) Macro Economics :- The study of Aggregate (total) level of Economic activities in a country is called Macro Economics.

→ It studies the flow of Economic resources / factors of production such as Land, Labour, Capital, Organisation & technology.

→ It deals with total Aggregates / output, total Employment (or) Invest.

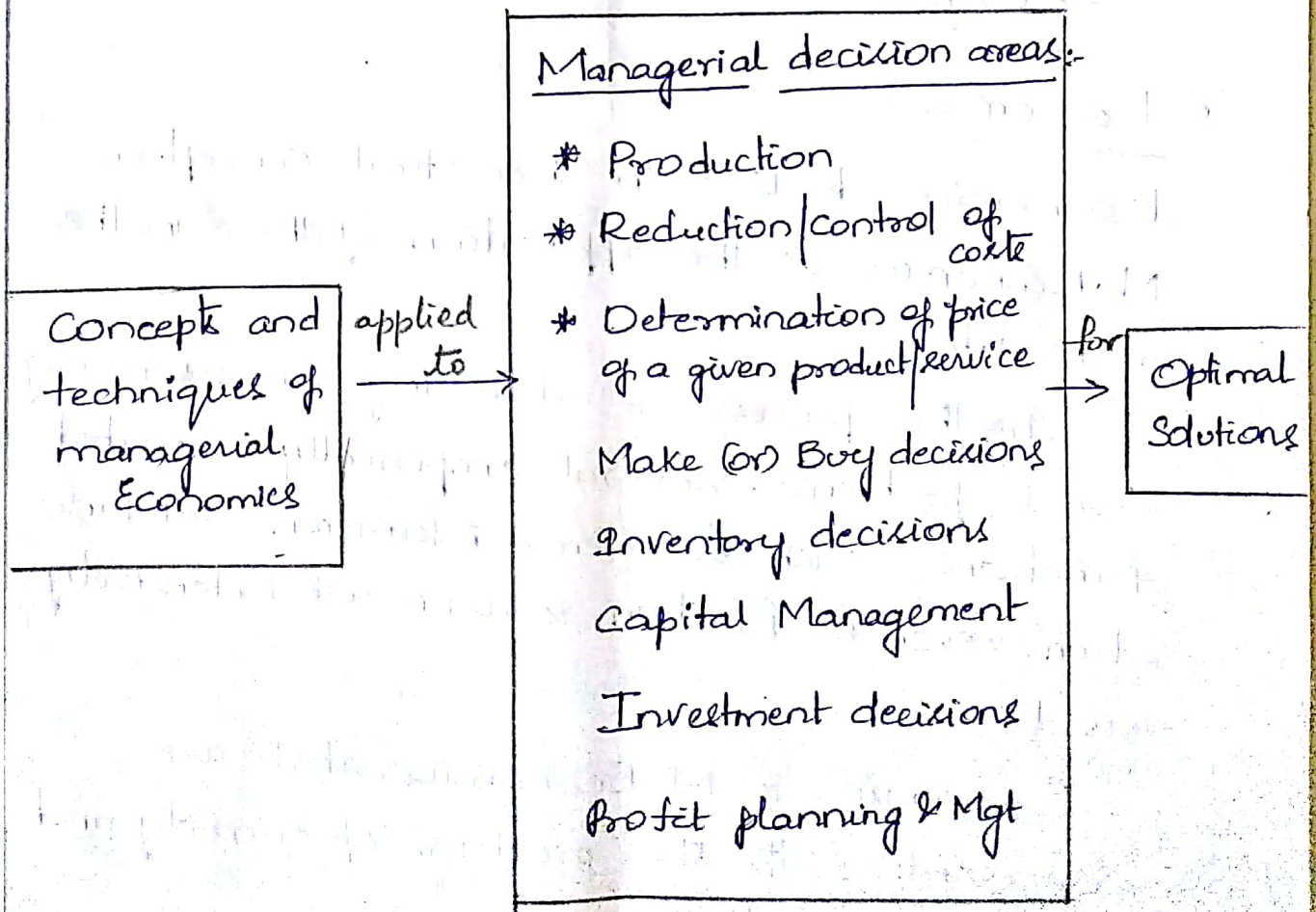
→ The important tools of Macro Economics include

- * National Income analysis ← GDP, NDP
- * Balance of payments ← Imports, Exports, P. Capital Income
- * Theory of Employment & so on

Scope of Managerial Economics :-

The main focus in managerial Economics is to find an optimal solution to a given managerial problem. The problems may relate to production, reduction/control of costs, determination of price of a given product/service, make or buy decisions etc.---

While for all these problems, the managerial economist makes use of the concepts, tools and techniques of economics & other related disciplines to find an "Optimal Solution" to a given problem.



Managerial Economics and its relation

With other subjects :-

Managerial Economics is closely linked with many other disciplines such as Economics, Accountancy, Mathematics, statistics, O.R, psychology, and org'l behaviour.

Let us see these linkages in detail :-

- Economics
- Operations Research
- Mathematics
- Statistics
- Accountancy
- psychology.
- Organizational Behaviour.

Economics :-

Economics deals with theoretical concepts, M.Economics is the application of these in the real life.

In the process of addressing various managerial problems; several empirically estimated functions such as demand function, cost function, revenue function & so on are extensively used.

Economics & M-Economics, both are concerned with the problems of scarcity and resource allocation.

Economics provide to the managerial economist,

- An understanding of general Economic environment within which the firm operates.
- A framework to solve the resource allocation problems.

3) Operations Research :-

"Decision making" is the main focus in Operations research and managerial Economics. If managerial economics focuses on "Problems of decision making", Operational Research focuses on solving the managerial problems.

It is used to establish Economic and logical relationships among the given variables. The O.R models such as *

- * Linear Programming
- * Queuing
- * Transportation
- * Optimization techniques & soon.

-are extensively used in solving the managerial problems.

Optimization is an interesting word. It refers to both "Minimisation of costs and maximization of revenues."

3) Mathematics :-

Managerial Economist is concerned with estimating and predicting the relevant economic factors for decision making and forward planning. In this process, he extensively makes use of the tools and techniques of mathematics.

such as *

- * Algebra,

- * Calculus.

- * Exponentials,

- * Vectors,

- * Input-output tables & each other.

4) Statistics :-

Statistics empowers the manager to deal with the situations of risk and uncertainty through its techniques such as Probability.

Managerial Economist extensively makes use of the statistical techniques such as...

- * Averages,

- * Measures of dispersion,

- * Correlation

- * Regression

- * Time series

- * Interpolation &

- * Probability & so on....

5) Accountancy:-

The Accountant provides accounting information relating to costs, revenues, receivables, payables, profits/losses etc...

The main objective of accounting function is to record, classify and interpret the given accounting data. The managerial economist depends upon accounting data for decision-making and forward planning.

6) Psychology:-

Consumer psychology is the basis on which managerial Economist acts upon.

How the customer reacts to a given change in price (or) supply and its consequential effect on demand/profits — is the main focus of study in managerial Economics.

7) Organisational Behaviour:-

To study & develop behavioural models of the firm integrating the manager's behaviour with that of the owner.

Concept of Demand

DEMAND ANALYSIS

Demand means the desire for any product/ (or) service that a person wishes to buy at a given price.

From Economics point of view, demand for a commodity refers to both the desire to purchase the commodity and the ability to pay for it.

“Every want supported by the willingness and ability to buy constitutes demand for a particular product or service”

Example:- If I want a car and I cannot pay for it, then, there is no demand for the car from my side.

So,
A product (or) service is said to have demand, when three (3) conditions are satisfied:

- * 1) Desire on the part of the buyer to buy.
- * 2) Willingness to pay for it.
- * 3) Ability to pay the specified price for it.

Unless all these conditions are fulfilled, the product is not said to have any demand.

Def:- According to 'Hibdon' → Demand means the various quantities of goods that would be purchased per time period at different prices in a given market."

Types of Demand

The nature and types of demand is better understood when we see these variations given below:-

D Autonomous Demand Vs Derived Demand:-

Autonomous demand refers to the demand for products and services directly.

Example:- The demand for the services of a super speciality hospital can be considered as autonomous, whereas the demand for the hotels around the hospital is called a derived demand.

In case of a derived demand, the demand for a product arises out of the purchase of a parent product.

Example:- If there is no demand for Houses, there may not be demand for steel, cement, bricks, and so on.

Demand for houses is Autonomous, whereas demand for these inputs is derived demand.

2) Firm Demand Vs Industry Demand :-

- The firm is a single business unit whereas,
- Industry refers to the group of firms carrying on similar activity.

The quantity of goods demanded by a single firm is called firm demand and the quantity demanded by the industry as a whole is called industry demand.

Example:- One construction company may use 100 tonnes of cement during a given month. This is firm demand.

The construction industry in a particular state may have used 10 million tonnes. This is industry demand.

3) New Demand Vs Replacement Demand :-

New demand refers to the "demand for the new product and it is addition to the existing stock. In Replacement demand, the item is purchased to maintain the asset in good condition.

Example:- The demand for new cars is new demand & the demand for spare parts is replacement demand.

Many companies announce exchange schemes for T.V's, washing machines & soon... they would like to tap the replacement demand.

Determinants of Demand

(or) Factors determining Demand:-

The demand for a particular product depends on several factors. The following factors determine the demand for a given product.

- (a) Price of the product (P)
- (b) Income level of the consumer (I)
- (c) Tastes and preferences of the consumer (T)
- (d) Prices of the related goods (Complementaries & substitutes (P_R))
- (e) Expectations about the prices in future (E_P)
- (f) Expectations about the income in future (E_I)
- (g) Size of population (S_P)
- (h) Distribution of consumers over different regions (D_C)
- (i) Advertising efforts (A)
- (j) Other factors (O)

Demand Function:-

Which describes a relationship between one variable and its determinants.

$$Q_d = f(P, I, T, P_R, E_P, E_I, S_P, D_C, A, O)$$

Where

Q_d = Qty demanded,

$f \rightarrow$ (functional relationship)

(a) Price of the product :-

Demand for a product is "inversely related" to its price. In other words, If price rises, the demand falls and Vice versa.

If price $\uparrow$, Demand $\downarrow$

(b) Income of the consumer :-

As the income of the consumer / household $\uparrow$ increases, there is tendency to buy more and more up to a particular limit.

The demand for product 'X' is "directly related" to the income of the consumer.

(c) Tastes and Preferences of the consumer :-

If the tastes and preferences of the consumers change, then there is change in the product demanded also. Most of the companies keep changing their products and services, as and when customer's tastes & preferences change.

(d) Prices of Substitutes (or) Complementaries :-

The demand for product 'X' is determined by the prices of its related products: Substitutes
Complementaries.

If there is an increase in the price of a substitute, the demand for product 'X' will go up & vice versa - Similarly, If the price of complementary good (to product X (tea)) goes up, the demand for product 'X' will fall.

Law of Demand

Law of Demand states that, "When the price increases, Quantity demanded decreases, & when the price decreases then automatically, Quantity demanded increases."

When,

Price $\uparrow$, Qty demanded $\downarrow$ &
Price $\downarrow$, Qty demanded $\uparrow$

While,

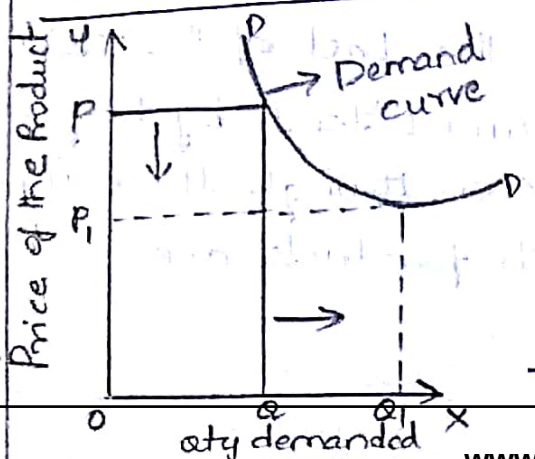
" " " " " "
Other things remaining constant (or) do not change

Operation of the Law of Demand :-

The Law of Demand explains that with every fall in the price of a particular product, its demand goes on increasing and vice-versa. This holds good as long as other determinants of demand do not change.

Once there is a change in other demand determinants, the law does not hold good.

Demand curve :- $\rightarrow$ "OP" is the Price & "OQ" is the Qty. dem



$\rightarrow$ If the Price falls from 'P' to 'P1', then the higher Qty OQ1 is bought

$\rightarrow$ DD is the Demand curve

$\rightarrow$ It shows inverse relationship b/w Price & Quantity

$\rightarrow$ Demand curve slopes downwards from left to right.

* "Exceptions" to the Law of Demand

There are certain exceptions to this law (or) this law does not hold good in the following cases.

- When there is shortage of necessities.
- Where the product is such that it confers distinction (prestigious goods).
- Giffen's paradox.
- In case of ignorance of price changes.
- Branded goods etc....

1) When there is shortage of necessities :-

If the customers fear that there could be shortage of necessities, then this law does not hold good. They may tend to buy more than what they require immediately, even if the price of the product increases.

2) Where the product is such that it confers distinction :-

Products such as jewels, diamonds and soon, confers distinction on the part of the user. In such a case, the consumers tend to buy (to maintain their prestige) even though there is increase in its price. Such products are called "Veblen goods".

3) Giffen's paradox :-

People whose income are low, purchase more of a commodity such as broken rice, bread etc. (which is their staple food) when its price rises.

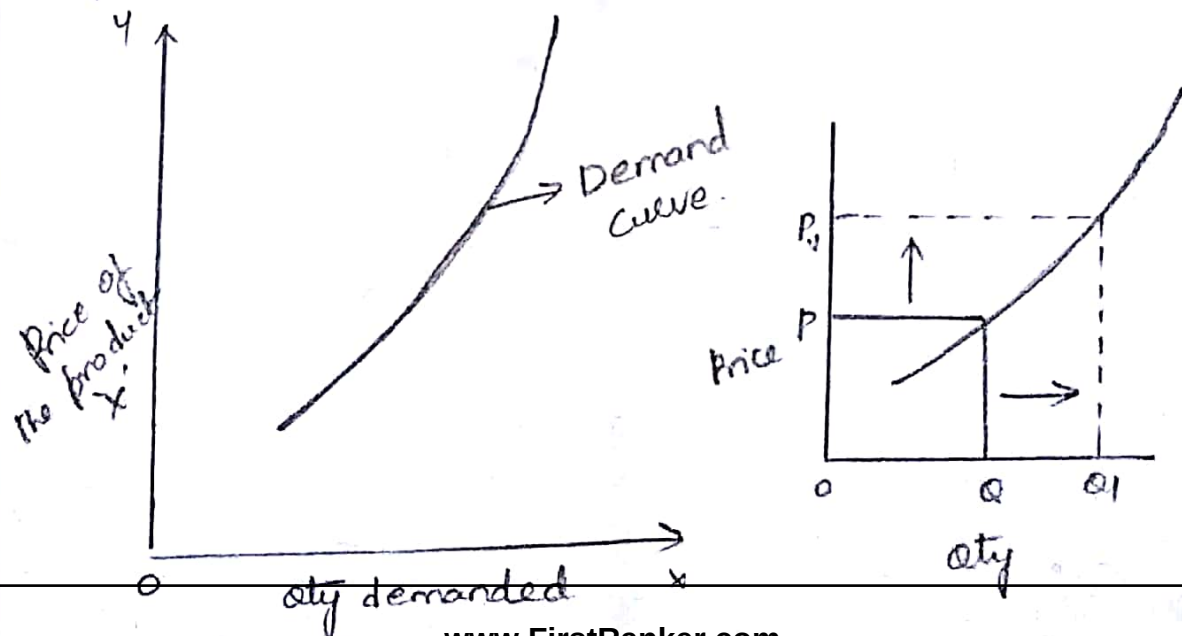
Conversely, when its price falls, instead of buying more, they buy less of this commodity and use the savings for the purchase of better goods such as meat and such goods are called inferior (or) giffen goods.

4) Incase of ignorance of price changes :-

All times, the customer may not keep track of changes in price. In such a case, he tends to buy even if there is increase in price.

An Exceptional Demand Curve :-

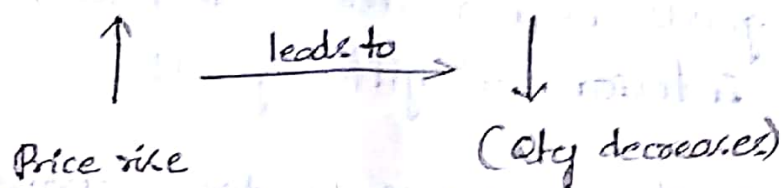
In case of these exceptions, the demand curve slopes upwards.



Demand Schedule

Def :- Meaning :-

The law of demand guides this relationship. It states that the quantity demanded will drop as the price rises. & vice versa,



Other things remaining constant.

Schedule :-

<u>Price of Potato</u> per kg, ₹	<u>Quantity demanded</u> of potato per weeks
5	8
4	20
3	38
2	60
1	90

The Law of demand expresses that, when the price of a commodity decreases ($\downarrow$), the Q.d ($\uparrow$) increases & vice versa, other things remaining constant. This law does not explain to what extent there will be a change in the quantity demanded for a given change in the price.

Elasticity of demand expresses the extent to which quantity demanded changes for a given change in the price of a commodity.

This concept is developed and popularised by "Alfred Marshall"

Definition:-

1) The elasticity of demand is a measure of the relative change in the amount purchased in response to a relative change in price"

— A. L. Meyers

2) The elasticity of demand, at any price (or) at any output, is the proportional change of amount purchased in response to a small change in price, divided by proportional change in price

— John Robinson

Types of Elasticity of demand :-

Elasticity of demand can be divided into 4 types :-

- ⇒ Price elasticity of demand.
- ⇒ Income elasticity of demand
- ⇒ Cross elasticity of demand.
- ⇒ Advertisement elasticity of demand.

Now,

1.) Price Elasticity of demand :-

$\frac{\% \text{ Change in qty demanded for product 'X'}}{\% \text{ change in price of 'X'}}$

$$E_d = \frac{(Q_2 - Q_1) / Q_1}{(P_2 - P_1) / P_1}$$

= -ve

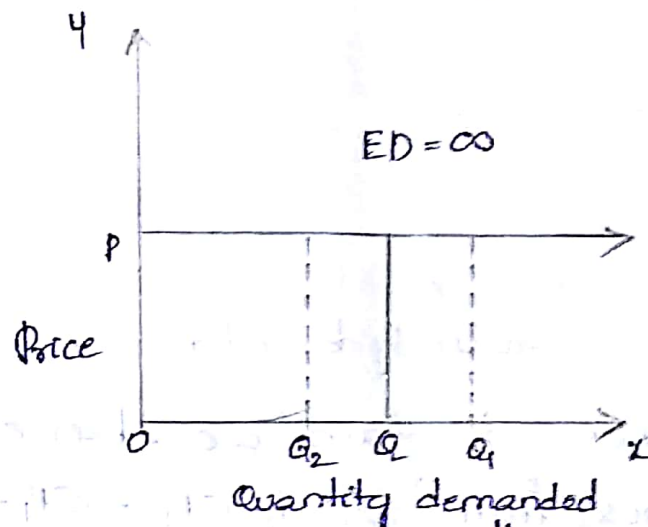
Price elasticity always negative.

The Elasticity of price is measured in the following ways :-

- (a) Perfectly Elastic demand
- (b) Perfectly inelastic demand.
- (c) Relatively elastic demand.
- (d) Relatively inelastic demand.
- (e) Unitary elastic demand

(a) Perfectly Elastic demand :-

When the demand for a commodity changes without any change in price, it is called perfectly elastic demand. These changes in price leads to infinite change in demand [$ED = \infty$]. The demand curve is a horizontal straight line.

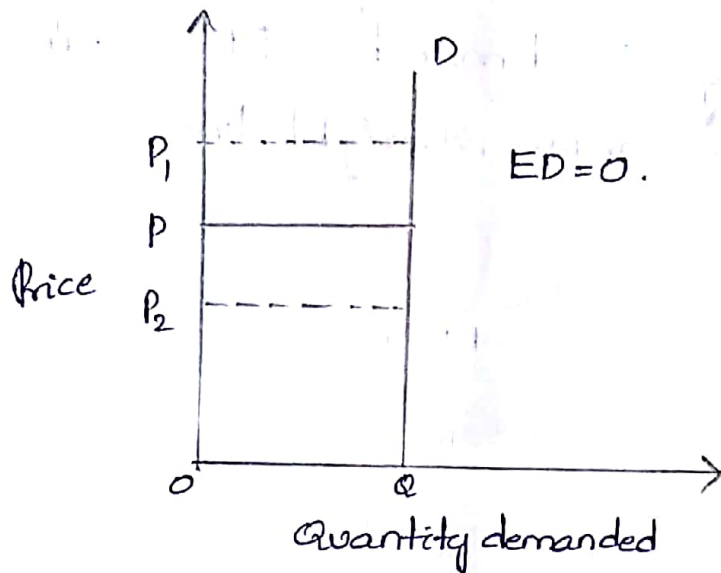


From the above diagram, the quantity of demand increases from OQ to OQ_1 , & decrease from OQ_1 to OQ_2 , even though the change in price will not takes place. But the price is fixed at "OP".

(b) Perfectly Inelastic Demand :-

The perfect inelastic demand is also called "zero elasticity". When demand does not change in spite of a change in the price of the product, it is called Perfectly inelastic demand.

Whatever may be change in price, quantity demanded will remain perfectly constant. In this case, the demand curve is a "Vertical straight line."



Example would be insulin to a diabetic.

From the above diagram, we observe that, price changes from OP to OP_1 , OP_1 to OP_2 , the demanded quantity, does not fall down. The quantity demand is constant. ($ED=0$)

Note

The concepts of Perfectly Elastic & Inelastic demand do not manifest in real life."

(P.T.O)

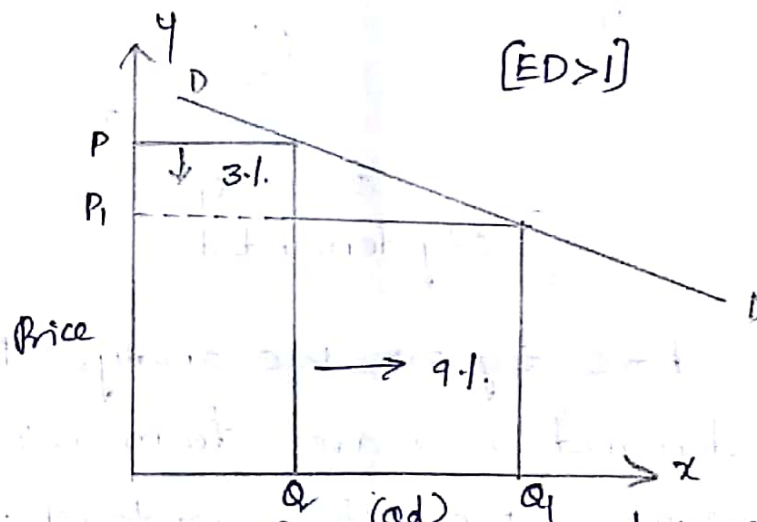
3) Relatively Elastic demand :-

When a small change in price lead to more than proportionate change in demand is known as relative elastic demand. In this method, the change in demand more than the change in price. Hence the elasticity is greater than one.

$$[ED > 1]$$

Example:- If the price of a product is falls by 3% and the demand increases by 9%.

$$\frac{2\%}{1\%} = 2 \quad [e > 1]$$



From the above figure, we observe that, 'OP' is actual price, & OQ is quantity demanded. Price decreases by OP to OP₁, & qty demanded increase by OQ to OQ₁.

Hence the demand is greater than 1; the shape of the demand curve is "Flat".

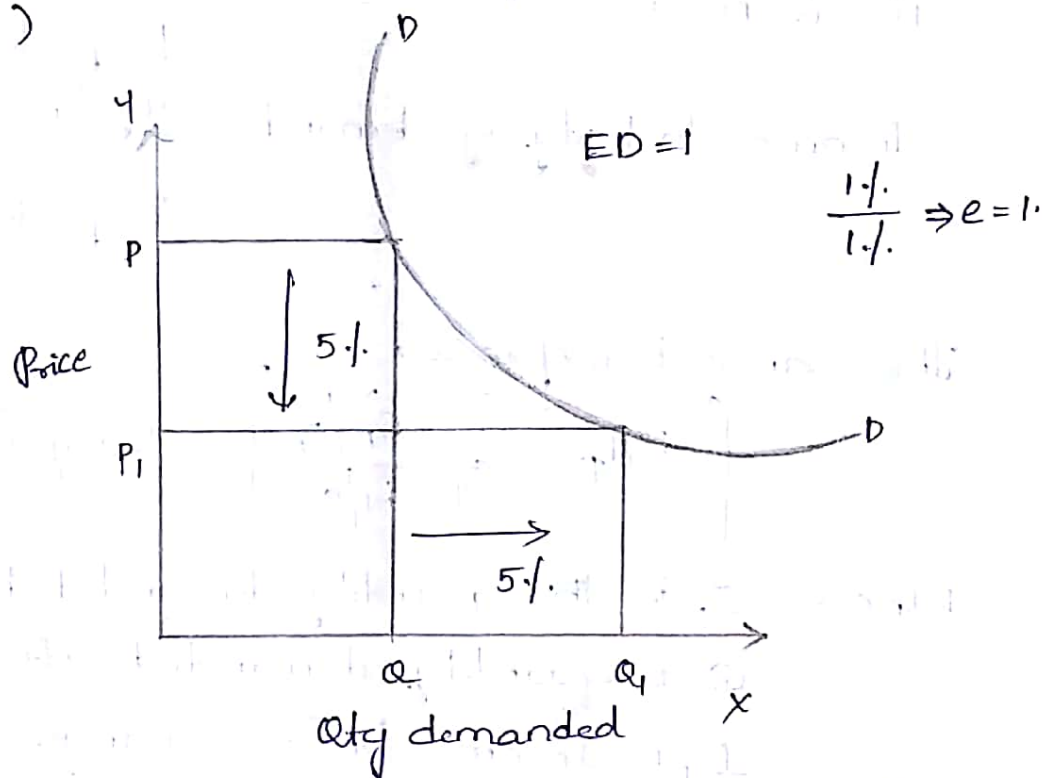
Example: Gold, Diamonds etc.:

5) Unitary Elastic Demand :-

Proportionate (percentage) change in demand is "equal" to proportionate change in price is called unitary elastic demand.

For example:- If 5% fall in price of a product leads to 5% increased in demand.

Hence, the elasticity of demand is 'equal' to unity (ED = 1.)



From the above figure, we analyse that, Qty increases by ~~Q~~ DQ to Q₁, due to the fall in price to P to P₁, thus the changes is the increase in qty. demanded is equal to the fall in price.

The shape of the demand curve is Rectangular Hyperbola

Example:- This will happen when there are close substitutes / Alternatives like clothing brands

"Income" Elasticity of demand

Income elasticity of demand refers to the quantity demanded of a commodity in response to a given change in income of the consumer.

Income elasticity is normally "positive", which indicates that the customer tends to buy more and more with every increase in income. It is measured as follows:-

$$\text{Income elasticity of demand} = \frac{\text{Proportionate change in qty demanded for prod 'X'}}{\text{Proportionate change in income.}}$$

The same is expressed as

$$\left[Ed_I = \frac{(Q_2 - Q_1)/Q_1}{(I_2 - I_1)/I_1} \right] \text{ always (+ve)}$$

Where Q_1 is the quantity demanded before change

Q_2 is quantity demanded after change.

I_1 is Income before change and

I_2 is Income after change.

A positive income elasticity indicates that the demand for the product rises more quickly, than the rise in disposable income.

In other words, the demand is more responsive to a change in income.

3) 'Cross' Elasticity of Demand :-

Cross Elasticity of demand refers to the quantity demanded of a commodity in response to a change in the price of a related good, which may be substitute (or) complementary good.

$$\text{Cross elasticity of demand} = \frac{\text{Proportionate change in quantity demanded for product 'X'}}{\text{Proportionate change in price of product 'Y'}}$$

The same is expressed as

$$Ed_c = \frac{Q_2 - Q_1 / Q_1}{P_2 - P_1 / P_1} \Rightarrow (+ve)$$

Where, Q_1 is the qty demanded before change,
 Q_2 is the qty demanded after change,
 P_1 is the price before change in the case of product Y.

P_2 is the price after change in the product Y.

Cross elasticity is always positive for 'substitutes',
& Negative for complementaries.

Example :-

Substitutes $\rightarrow$ Tea, coffee.

If coffee prices $\uparrow \rightarrow$ Demand for tea $\uparrow$ (+ve)

Complementaries $\rightarrow$ ~~Sugar~~, coffee, milk
power

Price of ~~sugar~~ $\uparrow \rightarrow$ Demand for coffee $\downarrow$ (-ve)
Coffee

4) "Advertisement" Elasticity of demand :-

It refers to increase in the sales revenue because of change in the advertising expenditure. In other words, there is a direct relationship between the amount of money spent on advertising and its impact on sales.

Advertising elasticity is always positive.

$$\text{Advertising elasticity} = \frac{\text{Proportionate change in Qty. demanded for product 'X'}}{\text{Proportionate change in Advertisement costs.}}$$

The same is expressed as

$$Ed_A = \frac{(Q_2 - Q_1)/Q_1}{(A_2 - A_1)/A_1} \Rightarrow (+ve) [e > 1]$$

Where Q_1 is the qty demanded before change, Q_2 is quantity demanded after change. A_1 is the amount spent on advertisement before change and A_2 is the amount spent on advertisement after change.

A small percentage change in the advertising expenditure results in a large percentage of change in the level of qty demanded (or) sales.

"Measurement" of Price Elasticity of demand :-

There are 3 methods for the measurement of price elasticity of demand.

They are :-

- 1) Total outlay method (Expenditure method.)
- 2) Point method (or) Geometric method.
- 3) Arc elasticity of demand method.

1) Total outlay method [Expenditure method]

In this method, Elasticity is identified on the basis of variation in the total outlay for a given change in price.

(or)

It examines the change in total outlay of the consumer/ total revenue of the seller corresponding to change in price of the product.

Even when there is a change in price but Total Revenue/exp remains unchanged ($e = 1$)

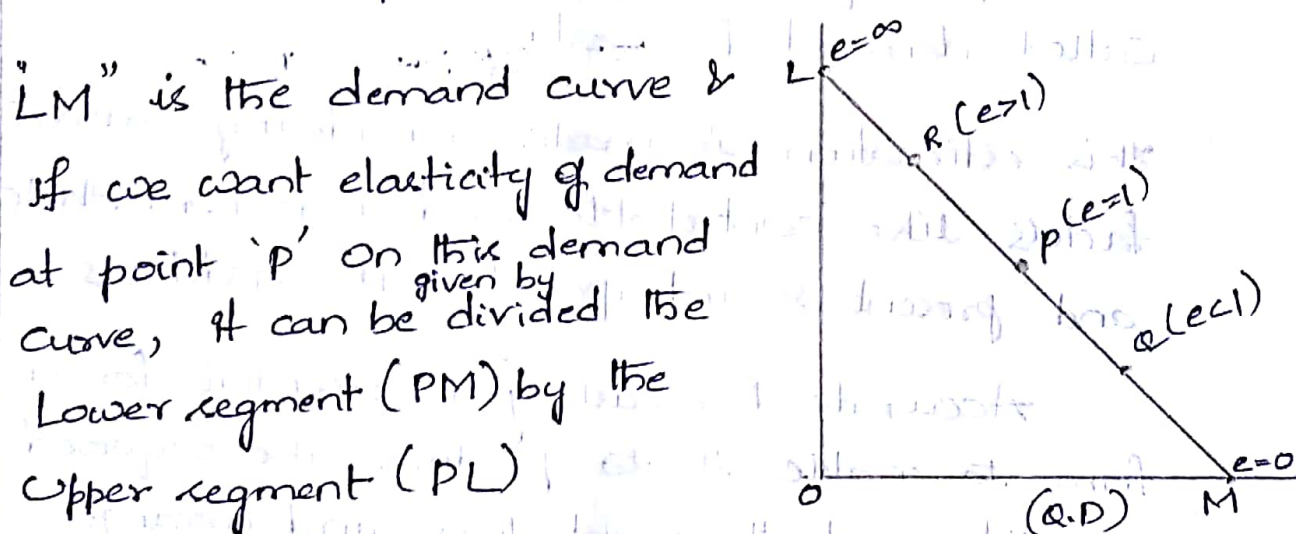
this can be explained through a schedule & diagram

Price (P)	Quantity demanded	Total outlay	
6	10	60	$e > 1$ $\left\{ \begin{array}{l} P \downarrow \rightarrow O \uparrow \\ P \uparrow \rightarrow O \downarrow \end{array} \right.$
5	20	100	
4	30	120	$e = 1$ $\left\{ \begin{array}{l} P \uparrow \rightarrow O \downarrow \\ \text{outlay constant} \end{array} \right.$
3	40	120	
2	50	100	$e < 1$ $\left\{ \begin{array}{l} P \uparrow \rightarrow O \uparrow \\ P \downarrow \rightarrow O \downarrow \end{array} \right.$
1	60	60	

* Point Elasticity Method

If the demand curve is a straight line sloping downwards from left to right (touching both axis), then the elasticity of demand at a given point on that demand curve, can be given by dividing the Lower segment by the upper segment.

It can be explained by means of following fig.



Elasticity of demand = $\frac{\text{Lower Segment}}{\text{Upper segment}}$

$$\left[E_p = \frac{PM}{PL} \right]$$

If we want elasticity at R, it will be $\frac{RM}{RL}$

If we want elasticity at Q, it will be $\frac{QM}{QL}$

Demand Forecasting - Evan J. Douglas

Meaning :-

The importance of demand forecasting is paramount when either production or demand is uncertain.

Expecting future demand of a product is called demand Forecasting."

This estimation is made considering various factors like controllable and non-controllable and present & anticipated mkt conditions.

Accurate forecasting is essential for a firm to enable it to produce the required quantities at the right time and arrange well in advance for the various factors of production like material, money, men & machinery mgt. etc..

The success of business depends upon the accuracy of forecasted reports.

A firm can maximize profits only when it produces on the basis of the demand for its product. There will be no problem of over and under production if the figure of sales forecasts (or) demand forecasts is accurate. Hence, the importance of forecasting is more or less depends upon the nature of business.

* Factors governing Demand Forecasting :-

- Time Factor
- Level Factor
- General (or) Specific purpose-factor.
- Product
- Nature of good.
- Competition.

1) Time Factor :-

Forecasting may be done for short-term (or) long-term. Short term forecasting is generally taken for 1 year, while long-term forecasting covering a period of 5 year, 10 year or 20 year period.

2) Level factor :- Business forecasting may be undertaken at 3 different levels.

a) Macro level :- It is concerned with business conditions over the whole Economy.

b) Industry level :- Prepared by different industries.

c) Firm level :- Firm level forecasting is the most important from managerial point of view.

3) General (or) Specific purpose factor :-

Demand forecasts can be worked out based on

- 1) Total sales &
- 2) Product/service-wise sales for a given time period.

⇒ Forecast in terms of total sales can be viewed as "general forecast."

where as,

⇒ Product / service-wise (or) region (or) customer segment-wise forecast is referred to as "specific forecast."

4) Product :-

Forecasting varies according to the type of product i.e. New product (or) Existing product (or) well established product.

5) Nature of goods :-

The goods are classified into producer goods, consumer goods, consumer durables & services. The patterns of forecasting in each of these differ.

6) Degree of competition :-

There may be single trader (or) a few trader depending upon the nature of goods & services.

7) Other factors :-

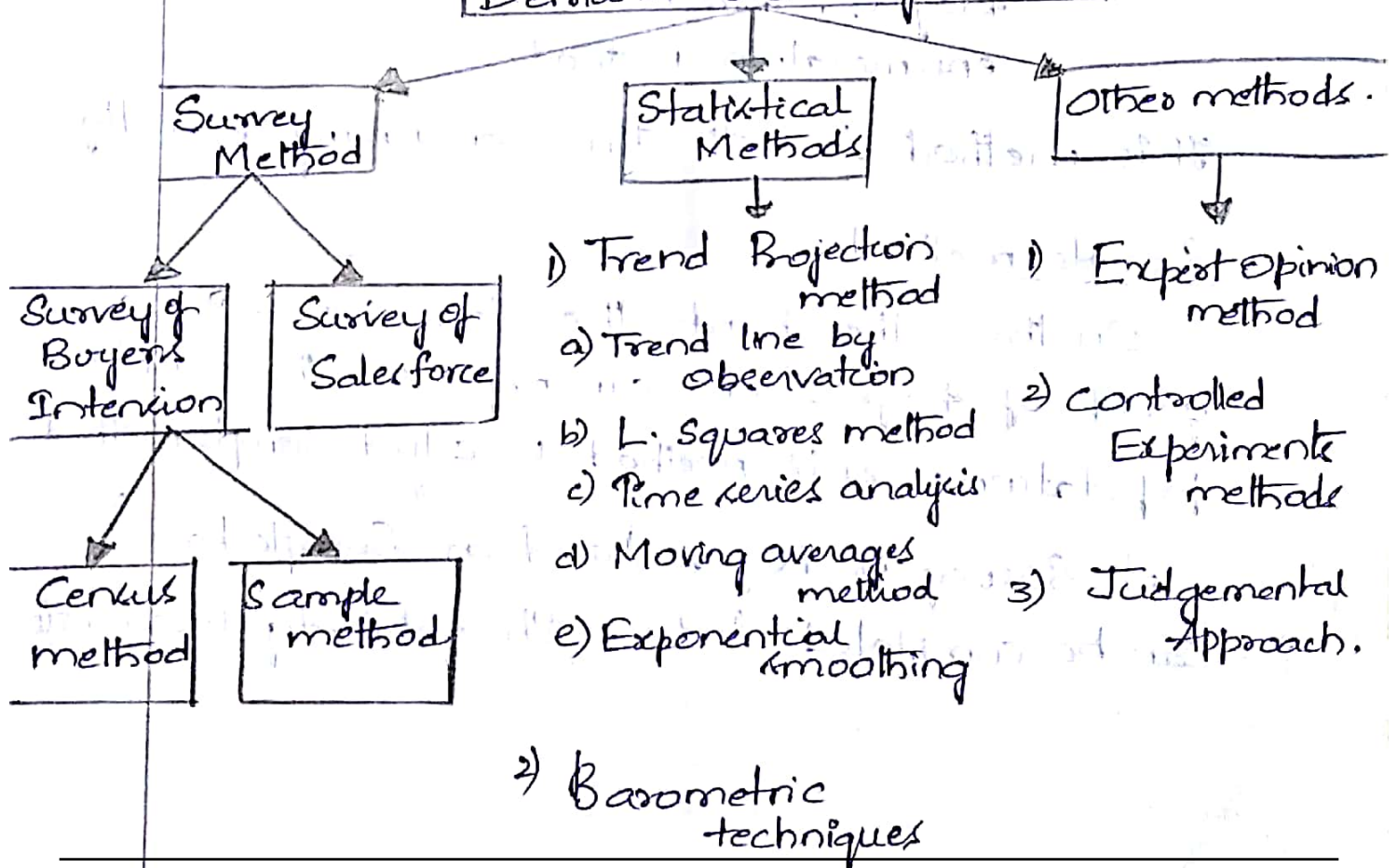
Every forecast of demand should clearly set the assumptions made about the demographic, Economic, technological, political and cultural environment.

Methods of Demand Forecasting

Forecasting demand is not an easy exercise. It may be easy only in the case of a very few products (or) services, where the demand for the product does not change from time to time, or competition is not significant, it may be relatively easy to forecast demand for a particular product/service.

In a majority of the cases, mkt demand in general and company demand in particular change from year to year. In such a case, the determining factor for marketing success is only a "good forecasting technique/method".

Demand Forecasting Methods.



1) Survey of Buyers' intentions are classified in to 2' (two).

They are 1) Census method (100% Enumeration method)
2) Sample method.

a) Census method :-

The survey can be conducted either by covering the whole population (or) by selecting a sample group of buyers.

Example → Suppose there are 10,000 buyers for a particular product. If the company wishes to elicit the opinion of all the buyers, this method is called census/ enumeration method.

This method is both time consuming & costly.

Sample method:-

On the other hand, the firm can select a group of buyers who can represent the whole population. This method is called Sample method.

A Survey of buyers based on "Sample basis" can be completed faster with relatively lower cost.

2) Survey of Sales force :-

The Sales force is capable of assessing the likely reactions of the customers of their territories quickly, and it is given to the company's marketing strategy. It is less costly as the survey can be conducted instantaneously through telephone, fax (or) Video-conferencing & soon...

This method is appropriate when:

- ⇒ Sales persons are likely to be most knowledgeable sources of information.
- ⇒ The Salesmen are co-operative.

Statistical methods :-

For Forecasting the demand for goods and services in the long run, statistical and mathematical methods are used considering the past data.

a) Trend Projection method :-

These are generally based on analysis of "past sales patterns". The necessary information is often already available in company files in terms of different time periods (ie) time series data.

There are 5 main techniques in T.P method

- 1) Trend line by observation
- 2) Least squares method
- 3) Time series analysis
- 4) Moving averages method
- 5) Exponential smoothing

2) Barometric method:-

While forecasting based on time series analysis (or) extrapolation may not yield significant results, barometric technique can be made use of under the barometric technique, One set of data is used to predict another set.

In other words, to forecast demand for a particular product (or) service, use some other relevant indicator (which is known as Barometer) of future demand.

Example:- The demand for cable T.V. may be linked to the number of new houses occupied in a given area.

Other Methods :-

1) Expert opinion method :-

Well informed persons are called Experts. Experts constitute yet another source of information. These persons are generally the outside experts and they do not have any vested interests in the results of a particular survey.

An expert is good at forecasting and analysing the future trends in a given product/service at a given level of technology.

2) Controlled Experiments method :-

In this method, the product is introduced with different packages, different prices in different markets (or) same markets to assess which combination appeals to the customer most.

This method does not provide better results, unless the markets are homogeneous in terms of tastes and preferences of the customers, their income & soon...

This method is still in infancy stage and not much tried, because it is costly & time consuming etc..

d) Judgemental Approach:-

When none of the above methods are directly related to a given product (or) service, the management has no alternative other than using its own judgement.

Even when the above methods are used, the forecasting process is supplemented with the factor of judgement.

MARKETS

Introduction :-

Markets constitute an important phase in the Economic activity. All the goods and services that are produced need to be sold to the consumer for a price. Markets facilitate this process.

We can't imagine a society without markets even for a while. Markets primarily provide ^(ownership) possession utility for the goods and services. In other words, the seller sells the goods to the buyer and thus transfers the ownership of the goods.

Definition :-

Market is defined as a place (or) point at which buyers and sellers negotiate their exchange of well-defined products (or) services.

Traditionally, market was referred to as a public place in a village or town where provisions and other objects were ^(purchase) bought & sold.

Based on the location, Markets are classified as rural, urban, national, (or) world markets. A market is said to exist wherever there is potential for trade.

Today with increasing technology and modern facilities, the definition of market has undergone a ^(great) sea change.

In the modern context, market refers to a meeting point of the buyer and seller, not necessarily a geographical one. It is not necessary that the buyer has to meet the seller in person. While traditional avenues such as Value payable by post (VPP) continued to be popular, e-commerce through the internet...etc...

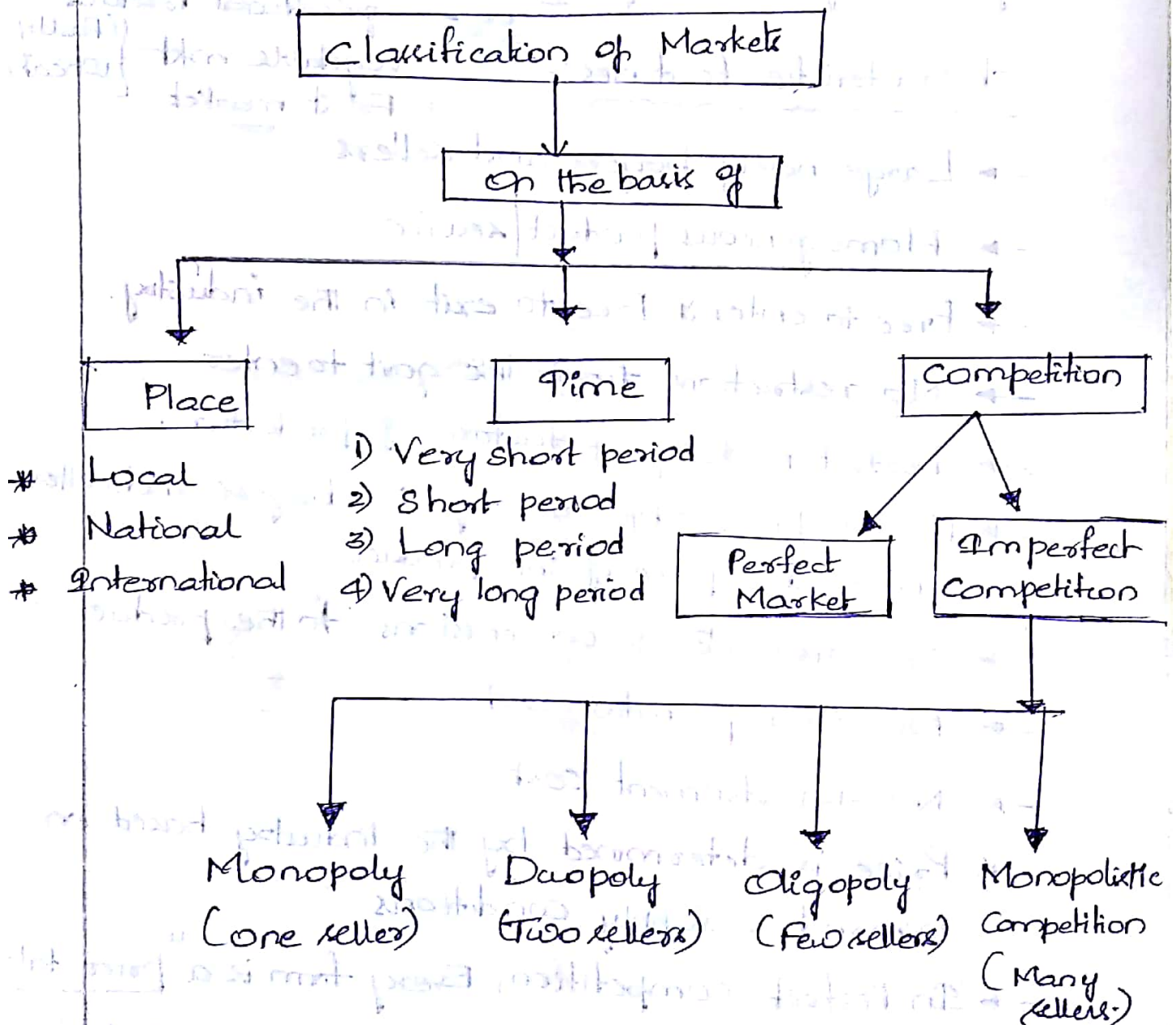
Size of Market :-

The size of mkt depends on many factors such as nature of product, nature of their demand, tastes and preferences of the customers, their income level, state of technology, extent of infrastructure including tele-communications and information technology, time factor in terms of short-run or long-run and so on....

The rapid technological development brought the entire community of buyers & sellers very close to each other.

Classification of Markets :-

Markets can be classified on the basis of place (or) region, time (or) competition, the following chart gives a clear picture about the classification of markets.

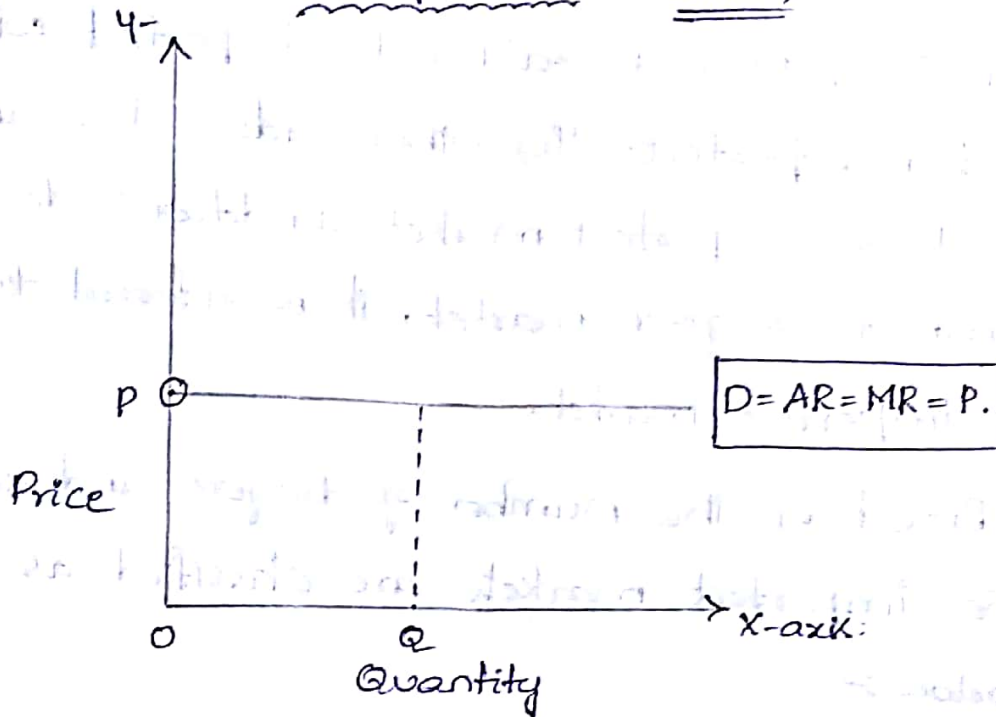


It is a market situation in which, there are large number of buyers and sellers selling homogeneous product. There is complete absence of rivalry (Monopoly) among the sellers.

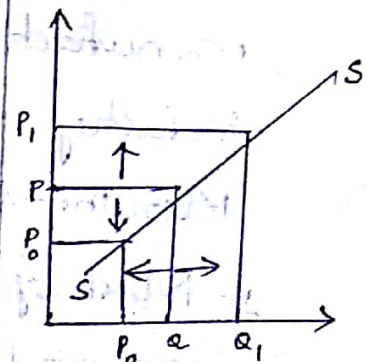
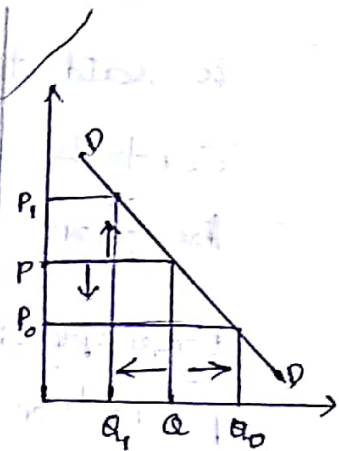
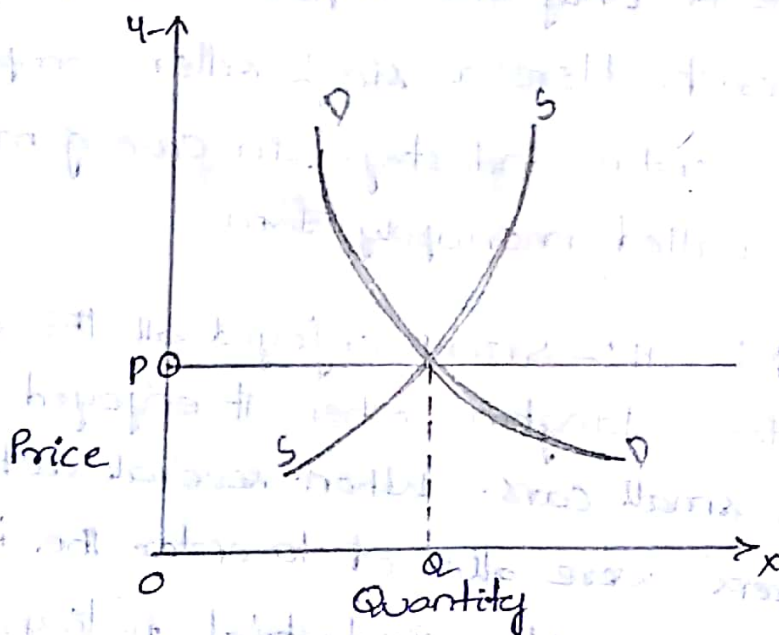
Characteristic features:- Ex. → Agricultural Products
→ Vegetable mkt { (Paddy, wheat etc)
→ Fruit market

- Large no. of buyers and sellers.
- Homogeneous product/service.
- Free to enter & Free to exit in the industry.
- No restrictions from the govt to enter
- Perfect mobility of factors of production.
- Perfect knowledge among the buyers and sellers about the price of the product.
- No discounts & concessions to the product
- No transportation cost
- No Advertisement cost
- Price is determined by the industry based on Demand & supply conditions.
- In Perfect competition, Every firm is a 'price-taker' that is decided by the industry as a whole.

Price & Output Determination under perfect competition (Firm)



Industry



→ Demand is equal to Average Revenue
Marginal Revenue
Price

→ Demand curve is parallel to -
- X' axis.

→ Demand is perfectly elastic in nature

A competition is said to be imperfect when it is not perfect. In other words, when any or most of the perfect market conditions do not exist in a given market, it is referred to as an imperfect market.

Based on the number of buyers and sellers, the imperfect markets are classified as explained below:-

1) Monopoly :-

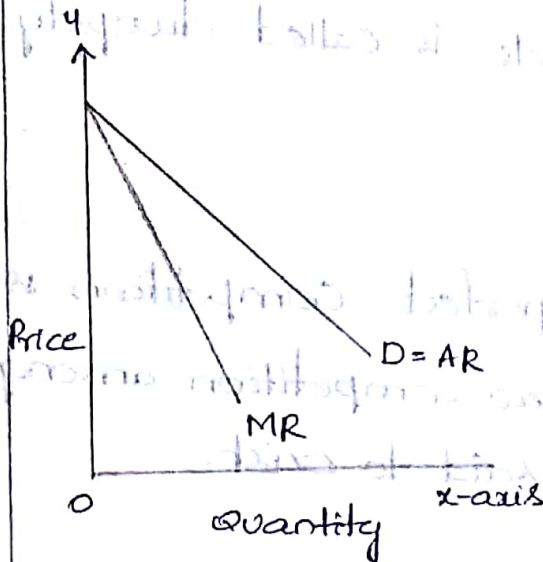
If there is only one seller, Monopoly mkt is said to exist. Here a single seller completely controls the entire industry. In case of monopoly, the firm is called monopoly firm.

Example:- Maruthi-Suzuki enjoyed all the govt protection for a longtime when it enjoyed monopoly in respect of small cars. When several automobile manufacturers were allowed to enter the Indian industry with the New Industrial policy, 1991, Maruthi-Suzuki's monopoly came to an end.

2) Most of the state Electricity Boards enjoy monopoly in terms of the generation and transmission of power.

Monopoly in short-run (Monopoly)

Monopoly



Getting Abnormal profits.

Conditions are :-

- 1) MR lies below the AR
- 2) SAC lies below the AR curve.

In Monopoly $MR < AR$

where, E = Profit optimizing output

$$TR = OPMQ$$

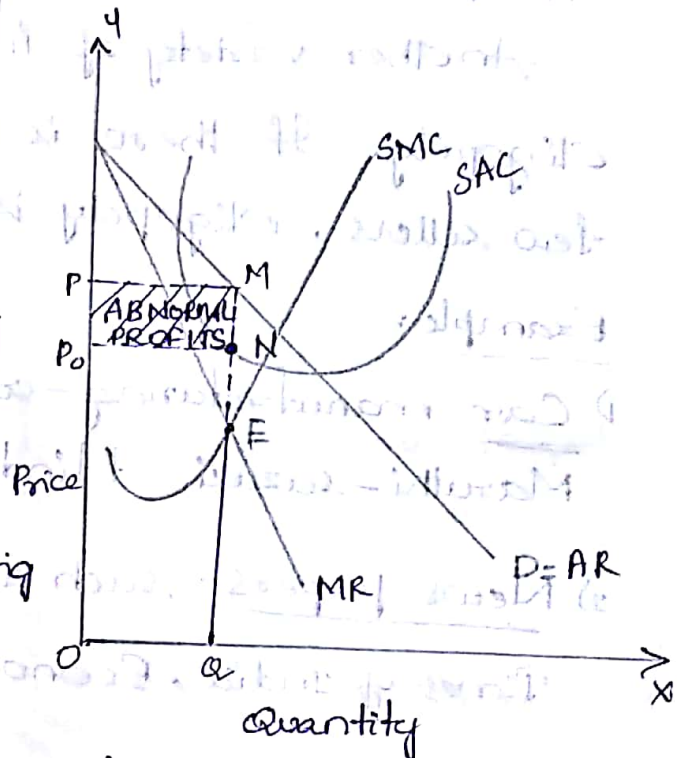
$$TC = OP_0NQ$$

$$T. \text{ Profits} = TR - TC$$

$$= OPMQ - OP_0NQ$$

$$= P_0PMN$$

where $MC = MR \rightarrow \text{Profit max output}$



AC-curve is 'U' shape and it is tangential

MC is always like Umbrella shape

→ In Long run also, Monopoly gets Super-Normal profits.

But here, In longrun, Economies of scale is achieved by Monopoly firm, because of size of the market, technology & other factors

If there are two sellers, duopoly is said to exist. If Pepsi & Coke are the two companies in softdrinks, this market is called duopoly.

3) Oligopoly :-

Another variety of imperfect competition is oligopoly. If there is few competition among few sellers, oligopoly is said to exist.

Example :-

- 1) Car manufacturing companies such as Maruthi-suzuki, Hindustan Motors, Toyota & so on
- 2) News papers such as ^{the} Hindu, Indian Express, Times of India, Economic times, Eenadu & so on.

Justification :-

When times of India reduced the price of the daily news paper, most of other companies such as Indian Express, the Hindu followed suit (do exactly)

Oligopolistic mkt situations are very common in the sectors relating to manufacturing, transportation & so on-etc.

④ Monopolistic Competition

This market competition exists, where many different firms produce goods which are differentiated from each other in at least one respect (unique feature)

So that, they are close substitutes, but not perfect substitutes.

Here, Large no. of small producers/suppliers having some degree of monopoly power because of their differential products. The differentiation depends upon the perception of the buyer. It may be real (or) artificial.

Differentiation comes from —

- unique feature
- Advertisement by celebrity
- Attractive packing
- Brand image etc...
- Perceptions of buyers.

SHORT-RUN

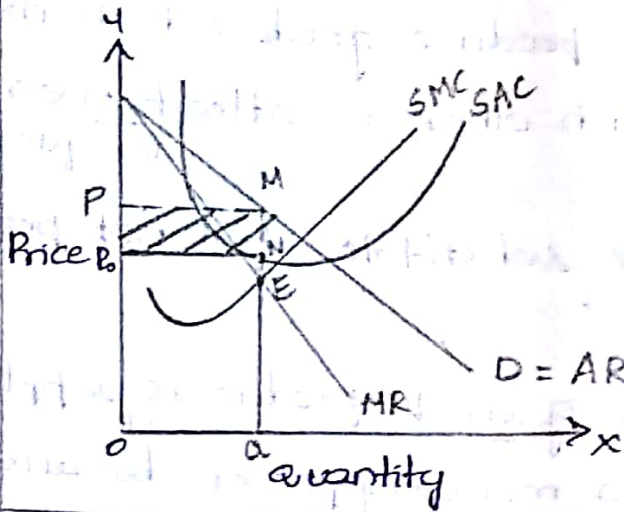
In Monopolistic competition, Producers may get

- a) Super Normal profits (Abnormal profits) (or)
- b) Normal profits (or)
- c) Losses.

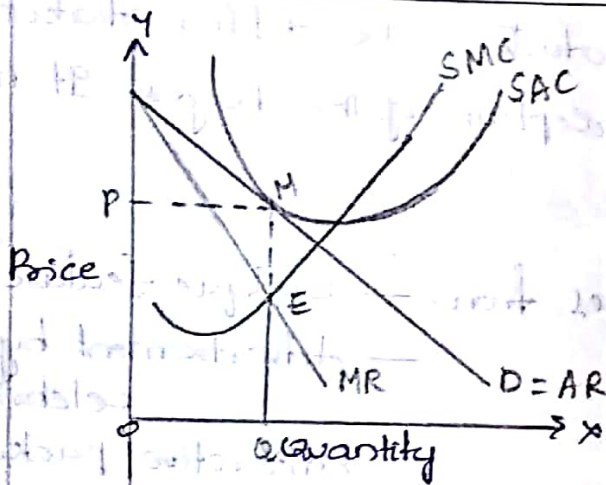
Long-run

Firms get Normal profits only.

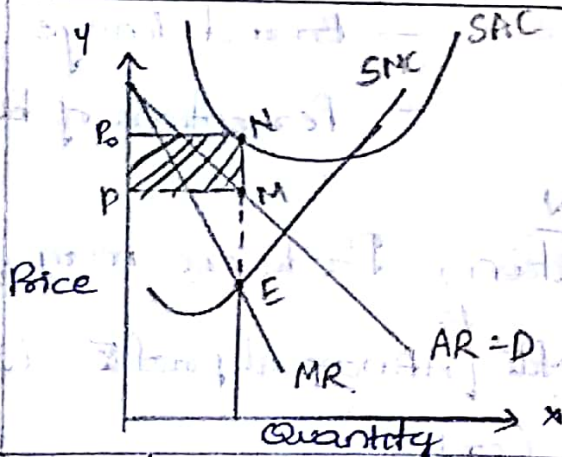
Price & output determination in Monopolistic Competition:-



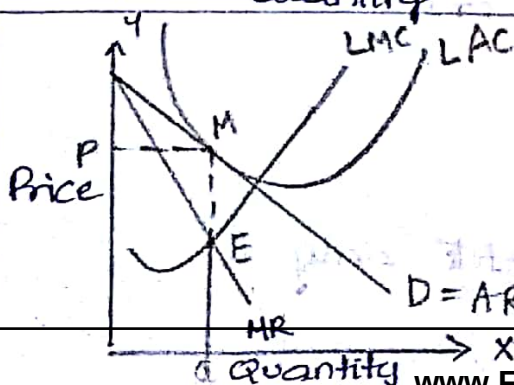
- a) Super Normal profit
- $MC = MR \rightarrow E$ (profit max-output)
- $\rightarrow$ We get profit area i.e. P_0PME
- $\rightarrow$ Expenditure area is OP_0NQ .
- $\rightarrow$ SAC cuts AR curve from below.
- $\rightarrow$ MR always lies below the AR.



- b) Normal Profit
- $AC = AR \rightarrow$ Normal profit
- $\rightarrow$ MR lies below AR.
- $\rightarrow$ E is the point of $MC = MR$ i.e. profit maximizing output
- $\rightarrow$ MC is like umbrella shape



- c) Loss
- P_0P_0NM is the loss area
- $\rightarrow$ SAC is above the AR curve
- $\rightarrow$ E is the point where $MR = MC$ - profit maximizing output
- $\rightarrow$ MR lies below the AR curve.



- $\leftarrow$ Long run
- Normal profit where 'E' is point $MC = MR \rightarrow$ Profit max output

- * Explain the concept of pricing & pricing policies?
Explain the different types of pricing methods-?

Introduction :-

Pricing is not an exact science. Pricing decisions, more often, are done by trial and error. Most often, we see discounts and concessions offered at the time of purchase. Sometimes, certain schemes are introduced wherein if you buy a packet (sachet) of tea powder, a shining steel table spoon is free!

Why all these provided-?
while the main objective of such schemes is to increase sales, one of the other objectives is also to correct the pricing strategy

Pricing is an important exercise.
under-pricing will result in losses &
over-pricing will make the customers run away.

To determine pricing in a scientific manner, it is necessary to understand the

- pricing objectives,
- Pricing methods,
- Pricing policies &
- Pricing procedures.

Pricing new products and services is relatively a difficult task. It is because there is no prior information (or) guideline available to fix the price.

In case of existing products, fixing price may be easy. because, there is a lot of information about the prices prevailing in the market and the experiences of the traders.

Pricing Objectives:-

Pricing objectives refer to the general and specific objectives, which a firm sets for itself in establishing the price of its products/services. & these are not much different from the marketing objectives (or) firm's overall business objectives.

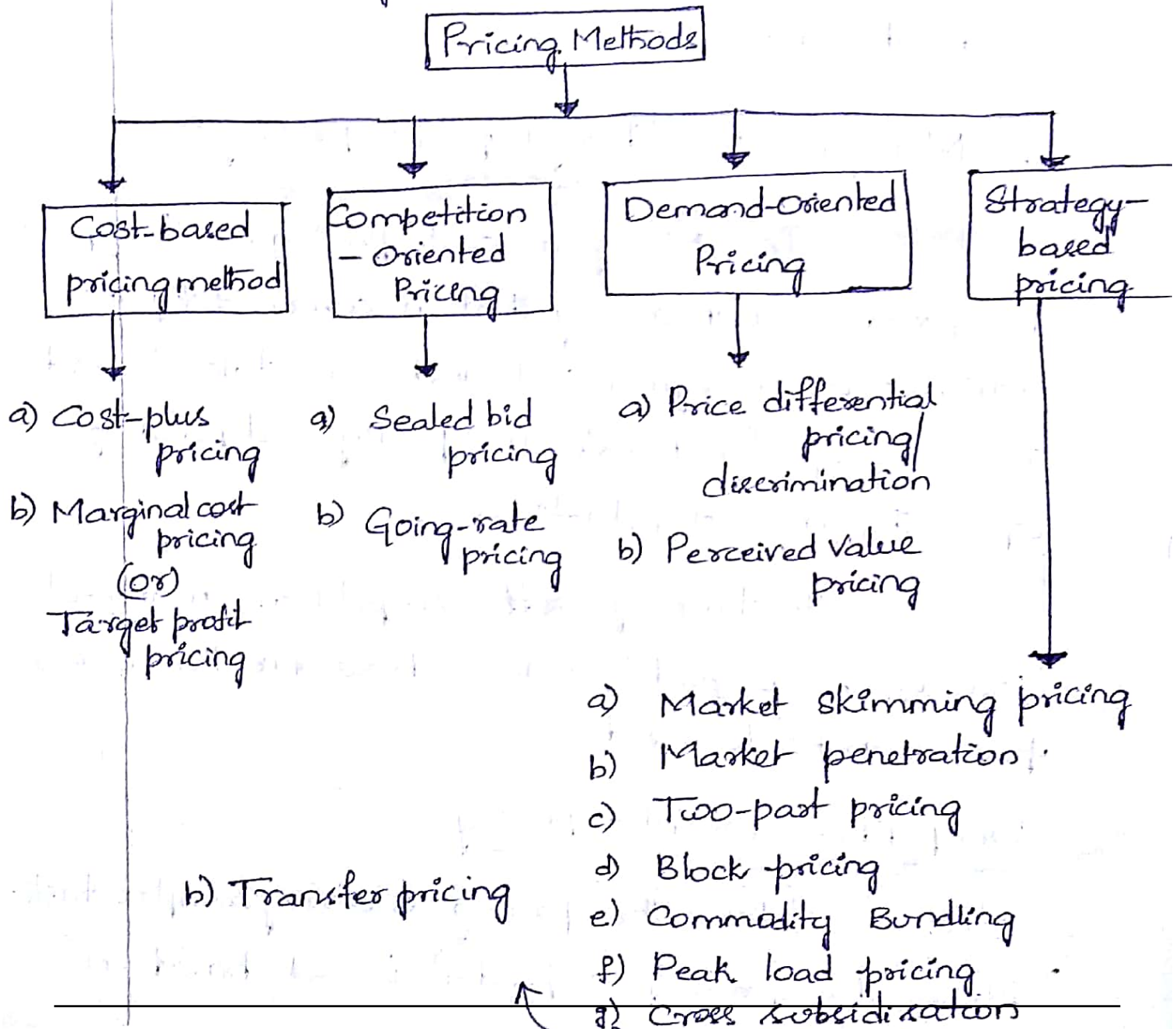
Generally, the following are the objectives of pricing:-

- a) To increase sales.
- b) To increase profits
- c) To increase the market share.
- d) To satisfy customers and
- e) To meet the competition.

Pricing Policy :- The firm has to formulate its pricing policies, particularly when it deals in multiple products. The pricing policies are intended to bring consistency in the pricing pattern. For instance, to maintain price differentials between the deluxe models & basic models and so on. Pricing policy defines how to handle complex issues such as price discrimination & so on.

Pricing Methods

The following are the different methods of



a) Cost-plus pricing :-

This is also called "Full cost" (or) "mark-up" pricing. In other words, find out the product unit's total cost and add a percentage of profit to arrive at the selling price. This method is suitable where the costs keep fluctuating from time to time. It is commonly followed in departmental stores and other retail shops.

b) Marginal cost / Target profit pricing :-

In Marginal cost pricing, selling price is fixed in such a way that it covers fully the variable (or) marginal cost and constitutes towards recovery of fixed costs (or) partly, depending upon the market situations.

In times of stiff competition, marginal cost offers a guideline as to how far the selling price can be lowered.

2) Competition-oriented pricing

Here the pricing is a very complex task. Here, the price of a product is set based on

(a) Sealed-bid pricing :-

This method is more popular in tenders and contracts. Each competing firm quotes its price in a sealed cover called "Tender". All the tenders are opened on a scheduled date and the person who quotes the lowest price, is awarded the contract. (Other things remaining the same)

b) Going-rate pricing :-

Here, the price charged by the firm is in tune with the price charged in the industry as a whole.

When one wants to buy (or) sell gold, the prevailing market rate at a given point of time is taken as the basis to determine the price.

3) Demand-oriented pricing :-

The higher the demand, the higher can be the price. Cost is not the consideration here. The key to pricing here is the value as perceived by the consumer. This is a relatively modern marketing concept.

a) Price-Discrimination:-

Price discrimination refers to the practice of charging different prices to customers for the same good. The firm uses its discretion to charge differently ^{to} the different customers. It is also called differential pricing.

Customers of different profiles can be separated in various ways, such as, ...

→ by different customer requirements

Ex (bulk & low gas supply to industrial & household consumers.)

→ by nature of product itself.

Ex: (Original & Replacement components of pressure cookers.)

→ by Geographical areas (Domestic & International mkt.)

→ by Income group [In govt hospital, patients are charged a high/low fee based on their income groups] & so on...

b) Perceived-value pricing:-

Perceived value pricing refers to where the price is fixed on the basis of the perception of the buyer of the value of the product.

4) Strategy-based pricing:-

a) Market skimming:-

When the product is introduced for the first time in the market, the company follows this method. Under this method, the company fixes a very high price for the product. The main idea is to charge the customer maximum possible.

This strategy is mainly/mostly found in case of technology products.

Example:- 1) When SONY introduces a particular T.V. model, it fixes a very high price.

2) When new series of pentium is released into market. It is priced very high.

Initially all cannot afford, except a very few.

As the time passes, the price comes down and more people can afford to buy.

This method can be followed only when

i. There is no threat from competition.

ii. A high price is coupled with high technology (or) quality.

(b) Market Penetration:

This is exactly opposite to the market skimming method. Here the price of the product is fixed so low, that the company can increase its market share. The company attains profits with increasing volumes and increase in the market share.

More often, the companies believe that it is necessary to dominate the market in the long run than making profits in the short-run. This method is more suitable where market is highly price-sensitive.

(c) Two-part pricing :-

The firms with market power enhance profits by the strategy of two-part pricing.

Under this strategy, a firm charges a fixed fee for the right to purchase its goods, (+) plus a per unit charge for each unit purchased.

Ex

Entertainment houses such as country clubs, athletic clubs, & health clubs usually adopt this strategy. They charged a fixed initiation fee (+) a charge per month/per visit to use the facilities

d) Block-Pricing:-

Block Pricing is another way, a firm with market power can enhance its profits.

We see block-pricing in our day-to-day life very frequently.

Six Lux soaps in a single pack (or)

Five Maggi Noodles in a single pack illustrate this pricing method.

Example:- Six Lux soaps

Each soap costs - 18/- & the soapbox is at 25/-

So the soap & box together $(6 \times 18/-) = 108 + 25 = 133$.

But the pack is offered at Rs 100/-, which is fairly attractive from the customer's side.

The consumer surplus here equal to Rs 33/-

e) Commodity Bundling:-

Commodity Bundling refers to the practice of bundling two or more different products together and selling them at a single "bundle price".

Example:- 1) Tourist companies & Airlines packages.

The package includes the Airfare, hotels, meals, sightseeing & so on at a bundling price instead of pricing each of these services separately.

2) Computer firms assemble PCs as per the customer specifications and offer them at a bundling price.

3) The car companies provide cars with air-conditioning, power steering, automatic transmission, Autogear & soon... & sell them at a special price.

f) Peak-load pricing:-

During seasonal period, when demand is likely to be higher, a firm may enhance profits by peak load pricing.

The firm philosophy is to charge a higher price during peak times than is charged during off-peak times.

Example:- Airlines such as Air India, Indian airlines, jet air & soon

Keep revising their fares/rates ^{for} every 3 months to charge higher fares during festival & holiday seasons.

Introduction:-

Different firms belonging to the same industry, facing the same market environment, behave differently. Thus, the necessity for theories of firm. The purpose of the theory of the firm is to provide models for the analysis of the decision making in the firm in various market structures.

A Theory of the firm needs to explain the entire range of price-output decisions —

- how the firms set their price
- decide their product line,
- advertisement expenses and
- sales promotion efforts,
- Research and Development expenses etc....

Economists, however, have viewed the ways in which managers take such decisions differently. In general, firms strive for Profit maximization. The traditional theory of the firm deals with this aspect:

But in the early 1930s, this theory faced several criticisms and dissatisfaction. The reasons are two

- ① Emergence of ~~Monopoly~~ ^{Oligopoly}
- ② Separation of ownership from Mgt.

These have been a number of different theories of the firm, which are as follows

① Profit Maximising theory (Marginalist theory of the firm.)

→ Innovation theory

→ Risk-bearing theory

→ Monopoly theory

→ Friction theory

→ Managerial Efficiency theory

② Baumol's Sales Maximising model.

③ Williamson's Model & Maximisation of Mgt Utility

④ Robin Marris model of Managerial Enterprise.

-x-

1) Marris Managerial theory of firm :-

(or)

Marris Growth Maximization model :-

Ans:- Marris' Growth Maximization model :-

According to Marris, - "Owners/shareholders" strives for attaining profits and market share & "Managers" strives for better salary, job security and growth. These 2 objectives can be attained by maximizing the balanced growth of the firm.

The Growth of the firm depends mainly on :-

- 1) → The growth rate of demand for the firm's products and
- 2) → Growth rate of capital supplied to the firm.

Marris found that the firm faces 2 difficulties while attaining the objective of maximization of balanced growth : which are -

- * Managerial difficulties &
- * Financial difficulties.

Managerial difficulties occur because of the inability of the managers to administer and attain optimum efficiency and the job security of the managers.

The Financial difficulties occur because of the difference that exists among the utility function of the managers which they try to attain for maximizing the utility function of the owner.

According to Marris, the growth rate of the firm (g_r) is

$$g_r = g_d = g_c$$

Where,

g_d = Rate of growth of demand for the firm's product

g_c = Rate of growth of capital supply to the firm.

Marris has given the Managerial utility (U_m) and owner's utility function as,

$$U_m = f(\text{Salary, power, status, job security})$$

Owner's utility function,

$$U_o = f(\text{profit, capital, output, market share, public esteem.})$$

Marris stated that the maximization of these variables helps the managers to optimize their own utility function as well as their owners utility function.

This is possible as the majority of the variables occurring in the manager's utility function such as salaries, status, job security, power etc.. and the variables occurring in the owner's utility function such as profit, capital, market share etc.. are associated with a single variable - size of the firm.

The maximization (or) optimization of these variables rely on the growth rate maximization of the firms. So the firms try to maximize a "constant (or) steady growth rate".

Merits of this model:-

- Marris growth maximization model helps in including the financial policies of the firm into the decision-making process.
- This model helps in providing a smart solution which maximizes the manager's and owner's utility.
- Marris model helps in attaining various objectives of the firms.

Demerits :-

- Maximizing the utility functions of owners and managers is "uncertain" as these two functions are not coincide or co-exist.
- All major variables such as profits, sales and costs increase at the same rate is highly unrealistic.
- This model is applicable to those firms which produce consumer goods. This model is not appropriate for analysing the behaviour of manufacturing businesses or traders.

2) Williamson's Managerial theory of firm:-

(or)

Williamson's Utility maximization model:-

Ans:- O.E. Williamson proposed a managerial theory of firm in which he outlined, that self interest encourages the managers to maximize their own utility function.

The utility maximization by the managers are affected by the limitation that after tax profits are sufficient for paying acceptable dividends to the shareholders and for paying the required investments.

Managerial utility function :-

Williamson stated that the utility function of the managers is influenced by several factors which are as follows:-

- 1) Salary and other Monetary Compensation.
- 2) Total no. of employees under the Manager's control.
- 3) Management slack.
- 4) Size of Discretionary Investment Expenditure.

Monetary compensation is the compensation which the managers receives from the business organization. As the salary and other monetary rewards which a manager obtains from the firm affects his standard of living and private expenditure. It is regarded as the most important factor influencing the manager's utility.

2) Total number of Employees under the Manager's control :-

The number of employees which are under the manager's control affects the status and reputation of the manager. If the no. of employees under the manager's control is high then the status and reputation of the manager will also be high. In other words, higher the number of employees under the manager's control, the higher will be the salary and other monetary rewards.

3) Management Slack :-

Mgt slack includes non-critical mgt requirements like large expenses accounts, effectively furnished offices,

lavishing cars etc.. These requirements are not heeded for carrying out the organizational operations effectively.

4) Size of Discretionary Investment Expenditure :-

This factor deals with the amount of resources which the managers can use at their freedom. The investment expenditures which are required for the firm's survival are not included in the discretionary investment. The size of the discretionary investment expenditure denotes the control which the managers have on resources.

Managerial - Utility Maximization :-

Williamson combines first two variables - Salary and other monetary compensation obtained by the manager and the total no. of staff under the manager's control.

In the Williamson's model, the manager's utility is a function of 3 variables i.e.

$$U = f(S, M, I_D)$$

where

$U \rightarrow$ Utility function

$S \rightarrow$ Monetary - staff expenditure such as salaries

$M \rightarrow$ Management slack.

$I_D \rightarrow$ Amount of discretionary investment.

The maximization of this utility function depends on the minimum profit constraint which signifies that the profit levels should be sufficient for paying satisfactory profit to shareholders and for paying the required investment.

Demerits :-

- $\rightarrow$ Williamson's model is a type of static model which cannot be used in dynamic situations in which the demand and costs keeps on changes (like in booms & depressions).
- $\rightarrow$ It is only suitable for the markets in which the rivalry is not strong.
- $\rightarrow$ This model does not solve the problems of oligopolistic interdependence & rivalry.

-x-

Articles of Association & Memorandum of Association

In corporate governance, a company's articles of association is a document which, along with the memorandum of association form the company's constitution, defines the responsibilities of the directors, the kind of business to be undertaken, and the means by which the shareholders exert the control over the board of directors.

Articles of Association — Overview:-

A company is an incorporated body, so there should be some rules and regulations formed for the management of its internal affairs and conduct of its business as well as the relation between the members & the company.

Moreover, the rights and duties of its members and the company are to be recorded.

- This is why Articles of Association are necessary.
- The Articles of Association is a 'document' that contains the Purpose of the company, as well as the duties & the responsibilities of its members defined and recorded clearly.

— It is an important document which needs to be filed with the Registrar of companies.

Memorandum of Association:- (MOA)

The objective and the purpose of the company are determined in advance by the shareholders and the Memorandum of Association (MOA), if separate, which denotes the name of the company, its Head-office, Street Address and Founding Directors & the main purpose of the company.

for public access.

It cannot be changed except at an AGM (or) Extraordinary General Meeting (EGM) and Statutory allowance.

The MOA is generally filed with a Registrar of companies who is an appointee of the Govt of the country. For their assurance, the shareholders are permitted to elect an Auditor at each AGM. There will be internal Auditors (employees) as well as External auditors.

~~Any~~

The Articles of Association of the company should be within the scope of the Memorandum of Association. Any matters in the Articles of Association not within the scope of the Memorandum of Association of the company is void. (invalid)

Traditionally, Computer was regarded as a tool which is helpful only to business tycoons and millionaires. But, with the growth and development of internet, the computer is not only used in small business concerns but also by ordinary individuals. At present, the world is influenced by internet and is used for several functions.

The growth and advancement in communication technologies such as telegraph, telephone, internet and cellular network services has depicted a uniform increase in total revenue with an improvement of quality & reduction in price.

Several commercial organizations which helps in providing access to the internet are regarded as backbone of the internet and are called as "Internet Service providers" (ISPs).

An internet service provider acts as an intermediary between the user and internet.

Selecting the most suitable pricing strategy is a very difficult task for the ISPs. The primary internet access pricing models which are

used by different ISPs are as follows :-

1) FLAT RATE PRICING :-

In the flat rate pricing, the internet user has to pay a fee for a specific time period during which the user will not be charged for the individual bit sent (or) received. In this pricing strategy, the user will not have to pay for the extra use of any new application. Several ISPs used this strategy. Initially, this strategy worked effectively but with a significant increase in the use of internet it was not possible to use this strategy.

2) Usage Sensitive Pricing :-

In usage sensitive pricing, the user pays the fee in two parts i.e.,

- one part of the fee is paid for connection and
- The second part of fee is paid for using the bit sent (or) received.

This pricing strategy is similar to two tariffs. The peak user pays the fee for

both the parts whereas an off-peak user pays the fee for only one part. The variable part depends on the time connection, connection-speed etc..

In the usage sensitive pricing, the pricing is done on the basis of the number of minutes of connection. The cost involved in implementing the strategy is very high.

3) Transaction based pricing $\rightarrow$ is a type of usage sensitive pricing. In this type of pricing, the user pays the first part of fee for connection and second part of fee for transaction.

The pricing is on the basis of transaction and not on the basis of usage. The transaction based pricing can be managed effectively by the ISPs.

4) Priority pricing:- In this model, the user choose the quality of services that they want and pay a fee for the same. This pricing allows the ISPs to charge more for important items

by depends on the paying capacity of users.

Types of Business Organization and Business cycles:

Business organizations are formed to do business to generate revenues / profits.

The following are the forms of business organization based on ownership.

- (a) Sole trader (or) Proprietorship.
- (b) Partnership.
- (c) Joint stock company.
- (d) Co-operative society.

SOLE TRADER

Features and Evaluation of Sole trader :-

The sole trader is the simplest, oldest and natural form of business organization. It is also called sole proprietorship.

'Sole' $\xrightarrow{\text{means}}$ One.

"Sole trader" implies that there is only one trader who is the owner of the business.

It is a one-man form of organization, where in the trader assumes all the risk of ownership carrying out the business with his own capital, skill and intelligence. He is the boss for himself. He is the owner, manager and controller. He has total freedom and flexibility.

Control lies with him. He can take his own decisions. He need not discuss with anybody.

He is responsible for himself.

this form of organization is popular all over the world.

Examples : Restaurants, Super-markets, Pan shops, Medical shops etc...

Features:-

- * It is easy to start a business under this form and also easy to close.
- * He introduces his own capital. Sometimes he may borrow, if necessary.
- * He enjoys all the profits and in case of loss, he alone suffers.
- * He has unlimited liability, which implies that his liability extends to his personal properties in case of loss.
- * Rates of tax, Example Income tax & so on are comparatively ^{very} low.

Advantages:-

- Easy to start and easy to close.
- Personal contacts with customers directly.
- Prompt decision-making.
- High degree of flexibility.
- Low rate of taxation.

Disadvantages :-

- Unlimited Liability
- Limited amounts of capital.
- No division of labour.
- Uncertainty (if any death)
- Inadequate for growth and Expansion.

Suitability :-

The sole trading business is a suitable form of organization where --

- Business is of small size and requires low volume of capital.
- Business can be managed by one person.
- Risk is low
- Personal attention is necessary to take care of the customers.
- Products / services need to be provided as per the customers specification / requirements.

- x -

PARTNERSHIP

Partnership is an improved form of Soletrader in certain respects. Where there are like-minded persons with resources, they can come together to do the business and share the profits/losses of the business in an agreed ratio.

Persons who have entered into such an agreement are individually called "Partners" and collectively called "Firm".

The relationship among partners is called a partnership.

Indian Partnership Act 1932 defines

Partnership as the relationship between two or more persons who agree to share the profits of the business carried on by all (or) any of them acting for all.

Features :-

- Partnership is a relationship among persons.
- There should be two or more number of persons.
- Business should be conducted.
- Persons should agree to share the profits/losses of business.

for all

- Unlimited liability to all the partners.
- Number of partners $\Rightarrow$ 10 partners in case of Banking business.
 $\Rightarrow$ 20 partners in case of Non-Banking business.

Partnership Deed :-

The written agreement among the partners is called the "partnership deed". It contains the terms and conditions governing the working of partnership. like *

- * Names & Addresses of the partners.
- * Nature of the business.
- * Duration.
- * Amount of capital | Profit sharing / losses also. ratio
- * Allocation of responsibilities of the partners in the firm etc..

Registration of Partnership :-

Registration of partnership is not compulsory. It is voluntary. An unregistered firm & its partners cannot file a suit against the third party in support of its claim. Hence it is desirable to get the firm registered with the Registration of Partnership Under Indian Partnership Act 1932 by

furnishing the details such as Name of the firm, Details of the main office, its location, address, its branch offices, date of admission of partners in to the firm and the addresses of the partners in the prescribed form along with the necessary fee for registration.

The main advantage of a registered firm is that, it creates confidence in the eyes of the public.

Advantages :-

- Easy to form and register a partnership.
- Availability of larger amount of capital.
- Division of labour.
- Flexibility
- Personal contact with customers.
- Quick decisions and prompt actions.

Disadvantages :-

* Formation of partnership is difficult.

Sarcastically said that — "It is easy to find a life partner, but not a business partner"
(Truely)

Suitability:-

the partnership form of business organization is popular, where the business —

- requires moderate volume of funds, as much as partners can bring.
- requires more persons of different skills which can be used for the common advantage of all partners.

The secret of partnership success over decades is the cohesive group of partners.

Kinds of Partners :-

- * Active Partner / working partner (active part on all affairs.)
- * Sleeping partner (just capital contribution)
- * Nominal partner (just name sake, No capital, No active part)
- * Partner by Estoppel. (Rule of evidence) — { Behaviour / conduct
He/she give impression to outsiders that he is the partner of the firm.
- * Minor partner → Having limited liability.

The word "company" derived from a Latin origin, "com" means "Come together", "pany" means "bread".

Joint stock company means, people come together to earn their livelihood by investing in the stock of the company jointly.

(JSC) It emerges from the limitations of partnership such as joint and several liability, unlimited liability, limited resources and uncertain duration & soon....

The main principle of JSC form is to provide opportunity to take part in business with as low investments as possible say Rs 1000/-

JSC has been a boom for investors with moderate funds to invest. Here the capital is divided into certain units. Each unit is called a share. The price of each share is kept so low that even a common man can find it comfortable to pick it up.

Companies that have been in existence before the enactment of Indian companies Act 1956, are called old companies

Sec 3(1) of the companies Act 1956, defines a company as "a company formed and registered under the Act or an existing company".

Features :-

- It is governed by Indian companies Act 1956.
- A company is an artificial person created by law. It can sell or buy properties in its name.
- Limited liability to every shareholder.
- The name of the company ends with 'limited'.
- Transferability of shares.
- Perpetual succession.

Formation :- [of JSC]

There are 2 stages in the formation of a Joint-stock company. They are :-

- (a) To obtain Certificate of Incorporation
- (b) To obtain Certificate of commencement of Business.

The certificate of Incorporation is just like a date of birth certificate. It certifies that a company with such and such a name is born on a particular day.

Certificate of Commencement of business authorises a public company to start its commercial operations officially.

A public company has to comply with certain requirements to obtain certificate of - commencement of business

A private company need not obtain the certificate of commencement of business. It can start its commercial operations immediately after obtaining the certificate of Incorporation.

Important Documents:-

* Memorandum of Association is also called "Charter" of the company. It has 6 clauses.

Name, situation, objects, capital, liability etc.

* Articles of Association deals with the byelaws of the company. Legal document Contains affr duties, responsibilities

* Prospectus is a circular, invitation (or) advertisement for subscription of shares.

<u>Points of difference</u>	<u>Public company</u>	<u>Private company</u>
1) Min & Max no. of members	Minimum - 7 Maximum - unlimited	Minimum - 2, Maximum - 50.
2) Transfer of shares.	No restrictions on transfer of shares.	Restricted.
3) Issue of prospectus	Prospectus can be issued.	Prohibited from issue of prospectus.
4) Acceptance of deposits	Can accept	Prohibited from accepting deposits from public. However, it can accept deposits from its members, directors or their relatives
5) Minimum paid-up capital	Rs 5 lakh (or) higher as may be prescribed	Rs 1 lakh (or) higher as may be prescribed.
6) The Name ends with	It ends with the word "Limited" (Ltd)	It ends with the word (Pvt Ltd)

Introduction :-

In capitalist Economies upward swing and downward swing occur at a regular intervals of time in economic activity. Such regular fluctuations in economic activity in an economy as a whole refer to business cycles (or) trade cycles.

Without the knowledge of the business cycles we cannot suggest suitable solutions to the problems of Capitalistic Economy.

Therefore the study of business cycles is essential for decision-making in business and production activities.

Definition :-

Business cycle is also known as "Trade cycle".
A business cycle is a wave like fluctuations of business activity characterized by recurring phases of Expansion and contraction in periods varying from 3 to 4 years.

1) "A Trade cycle is composed of periods of good trade characterized by rising prices and low unemployment percentages altering with periods of bad trade characterized by falling prices and high unemployment percentages"

→ Keynes

Characteristics of Business cycle :-

The features of a business cycle are as follows :-

1) Fluctuations :- Business cycle is characterized by fluctuations which occur periodically. This implies that the recurrence of expansion & contraction has no fixed.

2) Duration :- A typical business cycle completes itself in a period of 3 to 4 years. In some cases, duration of business cycle is shorter or longer than those of normal business cycle.

3) Alternative forces :-

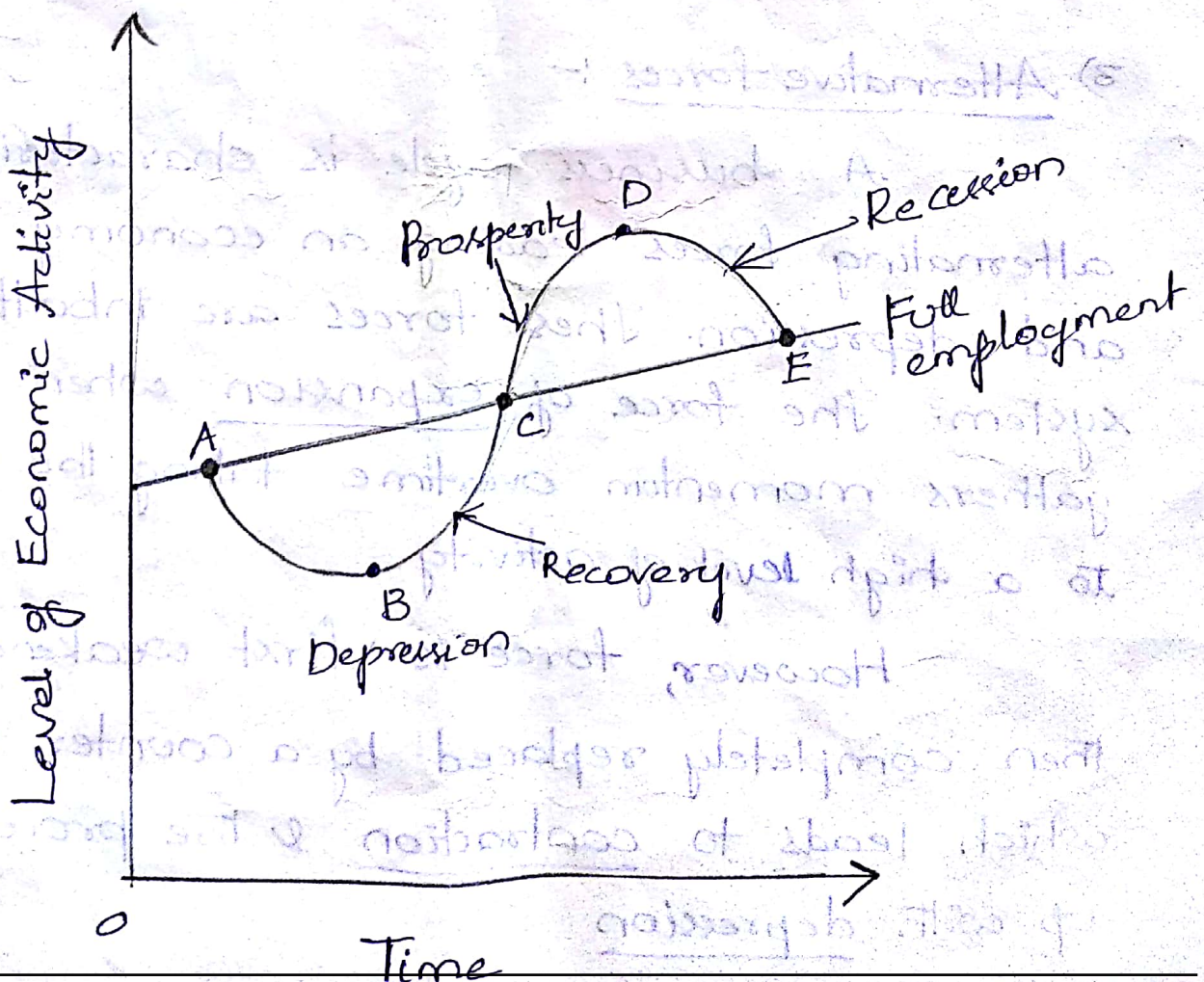
A business cycle is characterized by alternating forces leading an economy to prosperity and depression. These forces are inbuilt in the system. The force of expansion when born, gathers momentum overtime taking the economy to a high level of activity.

However, force is first weakened and then completely replaced by a counter force which leads to contraction & the process ends up with depression.

According to Keynes, an important characteristic of a business cycle is the phenomenon of crisis. This implies that the peak and the trough are a symmetrical ^{same shape/similar}. Normally, the prosperity phase of business cycle comes to an end, whereas recovery after the depression is gradual and slow.

Phases/Process of Business Cycle:-

A trade cycle has 5 different phases as shown in figure.



Depression is a phase in which the level of economic activity is extremely low.

It is a period of utter pessimism due to heavy losses and unemployment in the economy. ^(things turn out bad)

2) Recovery :-

Recovery phase is based on business and economic activity. Prices start rising and so to wages, interest and profits. Pessimism gives place to optimism in this phase.

3) Full employment :-

Full employment is reached in the economy due to the continuation of cumulative process of economy.

4) Boom :- flourish

Boom is the result stage for prosperity which leads for continuous optimistic investment by businessmen. This over-optimism ^(Things turn out good/well) puts an extra pressure on factors of production which results in rising inflation.

5) Recession :-

Recession appears when businessmen realize their mistake of heavy investment. Business expansion stops and activities slow down.

& its types - ?

They are also known as "Public undertakings" or "Public sector undertakings".

A Public sector enterprise (or) a public enterprise is one which is owned, managed and controlled by the central government (or) any state government (or) by any local authority.

Need / Objectives of Public Enterprises :-

Synopsis :-

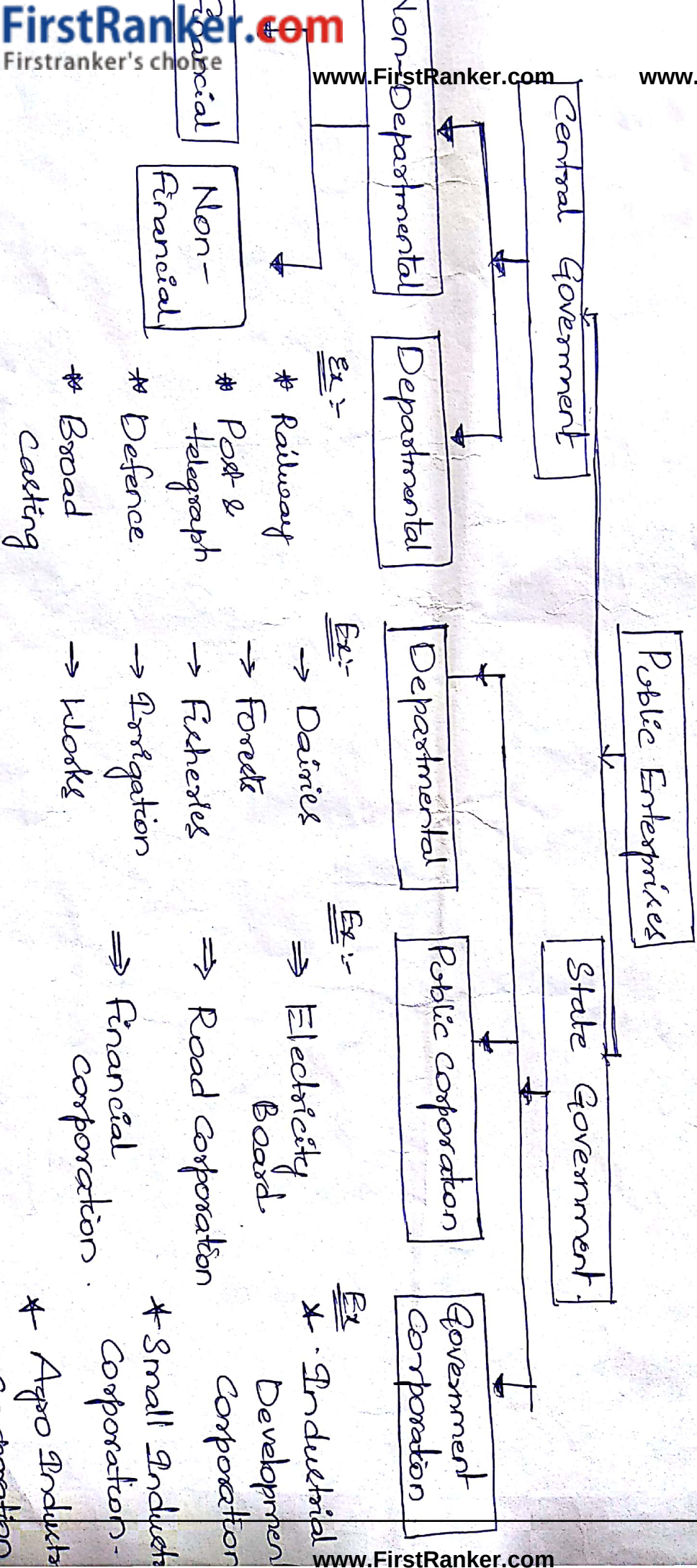
- * To provide Infrastructure — like railways, roads, power, telecom, irrigation etc.
- * To fill the gaps left by the private sector — like big projects.
- * Avoid monopolies — avoid Black marketing, avoids restriction of output, creation of artificial scarcity & charging of high prices.
- * To promote public welfare — To ensure that even public gets essential products & services at an affordable price.
- * To reduce inequalities — means equitable distribution of available resources.
- * To utilize Resources — means natural resources in an optimum (maxi) manner.
- * To Develop backward areas — It ensures that

Balanced Regional Development.

Forms / Types of Public Enterprises

State Enterprises are organized in one of the following forms.

- Departmental undertaking.
- Public corporation.
- Government company.



Ratio Analysis

UNIT - V

INTERPRETATION & ANALYSIS OF FINANCIAL STATEMENTS

A Ratio is a simple mathematical expression. Analysis of financial statements is an (expression) interpretation of financial results.

Financial Analysis through ratios is the process of identifying financial strengths and weakness of the firm by properly establishing relationships by means of ratio b/w the items of the Profit & Loss a/c and balance sheet.

Ratio analysis is useful to shareholders, creditors, and all other parties who are connected with the concern.

Importance:

- * Ratios act as an index of efficiency of a concern
- * They are useful in evaluating performance
- * They facilitate and help in forecasting future events
- * They help management in exercising effective decisions.
- * They help management to take corrective actions.
- * They play effective role for easy and clear Communications

Types of Ratios :-

- 1) Leverage Ratio :- (Capital structure ratios)
→ They are used for studying longterm financial strengths.
- 2) Liquidity Ratios :- They are used for studying shortterm financial strengths (survival, growth and operating efficiency of the firm)
- 3) Profitability Ratios :- They are used for studying survival, growth and operating efficiency of the firm
- 4) Turnover Ratios :- (Activity Ratios)
They are used to measure the efficiency with which the firm manages and uses its Assets.

— x —

Interpretation:-

Current Ratio is 2:1, It means for every one rupee of Current Liability, there is a coverage of two rupees of current assets. The standard norm of current ratio is $\boxed{2:1}$.

Liquidity ratio is 2:1, It means for every one rupee of quick liability, there is a coverage of two rupees of quick assets.

The standard norm of quick ratio is $\boxed{1:1}$.

Therefore the liquidity position of the company is satisfactory.

- x -

Illustration - 2

- 1) Cash - 3,000
- 2) B/R Receivable - 10,000
- 3) Debtors - 80,000
- 4) Creditors - 1,20,000
- 5) Bank - 65,000
- 6) Stock - 1,20,000
- 7) Prepaid Expenses - 2,000
- 8) Bills payable - 20,000

Calculate a) Current Ratio
b) Acid Test Ratio.

Hint 1) Acid test Ratio = Quick Ratio $\Rightarrow \frac{\text{Quick Assets}}{\text{C. Liabilities}}$
2) Quick Assets = C. Assets - (Stock + Prepaid Expenses)

Sol.

$$a) \text{ Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Now

$$\begin{aligned} \text{Current Assets} &= \text{Cash} + \text{B/R} + \text{Debtors} + \text{Bank} + \\ &\quad \text{Stock} + \text{Prepaid Expenses} \\ &= 3000 + 10,000 + 80,000 + 65,000 \\ &\quad + 1,20,000 + 2,000 \\ &= 2,80,000. \end{aligned}$$

$$\begin{aligned} \text{Current liabilities} &= \text{Creditors} + \text{Bills payable} \\ &= 1,20,000 + 20,000 \\ &= 1,40,000. \end{aligned}$$

$$\text{Here } C.R = \frac{C.A}{C.L} \Rightarrow \frac{2,80,000}{1,40,000} = \boxed{2}$$

$$b) \text{ Acid Test Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned} \text{Now Quick Assets} &= \text{Current Assets} - (\text{Stock} + \text{Prepaid Expenses}) \\ &= 2,80,000 - (1,20,000 + 2,000) \\ &= 2,80,000 - 1,22,000 \\ &= 1,58,000. \end{aligned}$$

Here

$$A.T.R = \frac{Q.A}{C.L} \Rightarrow \frac{1,58,000}{1,40,000}$$

$$= 1.12.$$

—X—

Ratio Analysis :-

①

To determine the numerical relationship b/w the fundamental financial statement It is easy to understand the financial problem

Def: Ratio can be expressed in terms of percentages, proportions, quotients also

→ It is statistical measure that relation b/w two variables

Types of Ratio

- 1) Liquidity ratios
- 2) Activity ratios
- 3) Capital structures
- 4) Profitability ratios

Liquidity ratios :- If the firm is not a position.. The firm run by the short term commitment such as payment of taxes, wages, salaries and so on it can't run the business for long term based on capital

② ! Liquidity ratio help in identify the dangers signals for the firm in advance.

Liquidity 2 types

- 1) Current Ratio
- 2) Quick ratio.

Current ratio is at least 2:1

The ratio b/w Current Asset & Current liabilities is 2:1.

Current ratio is called as working capital.

Quick Ratio :- Acid test ratio

Convert Current assets quickly into cash to meet its Current liabilities

Quick Ratio = Quick Asset / Current liabilities

Quick asset = Current asset - (Stock + prepaid Expenses)

Activity ratio :-

Activity ratio express how active the firm in terms of selling its stock, collecting its receivables and paying its creditors

There are 3 types

1) Inventory turn over ratio :- It helps ~~to~~ ~~to~~ to determine the liquidity of the firm by giving the rate at which inventories are converted into sales and then to cash.

② Debtors turn over ratio :- It show how quickly the firm is in a position to collect its debts, firm is not in a position to collect its debts. To meet the working capital requirement It has to borrow paying interest

It show how firm is in a position to pay its Creditors. If firm is not in a position to pay its Creditors, it will affect the good will & further supplies may be cut off - to be on safe side

Capital structure (Leverage Ratios)

Ratio is defined as "financial ratio which focus on the long term solvency of the firm. The long term solvency of the firm is always reflected in its ability to meet its long run commitments such as payments of interest periodically without fail

The following are the most commonly used Capital structure

1) Debt equity ratio :- The ratio b/w outside funds and inside funds. It is measure of solvency. The ratio is 1:1
one rupee of debt, ~~there~~ ^{there} should be one rupee of internal funds.

Outside funds :- debentures, bonds, long-term loans.

Inside funds :- reserves, share capital.

② Interest coverage ratio :- No problems to pay the interest
=
$$\frac{\text{Net profit before interest \& taxes}}{\text{Fixed interest charges}}$$

③ Ratio of Proprietors funds to ^{total} Assets

The relation b/w. Proprietor funds and total Assets are
=
$$\frac{\text{Proprietor funds}}{\text{total Asset}} \times 100$$

Profitability ratio :-

The owners expect reasonable rate of return on their investment.

Gross profit ratio :- The ratio b/w Gross profit to sales during given period

$$\text{Gross profit} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

Important Points:

- 1) Current Assets = Cash, Bank, Stock, Debtors,
Bills Receivable, Prepaid Expenses,
Accrued Income, Short term Investments.
- 2) Current Liabilities = Creditors, Bills payable,
Bank overdraft, shortterm loans
(loans payable within 1 year)
Outstanding Expenses, Proposed Dividend,
Provision for Taxation,
Income received in advance.
- 3) Quick Assets / Liquid Assets } = Cash, Bank, Debtors, B/R
- 4) Super quick Assets = Cash and Bank.
(Absolute liquid Assets)
- 5) Long term liabilities = Debentures, Longterm loans,
Redeemable preference share capital
- 6) Shareholders funds = Equity share capital, P & L acc.
Preference share capital, Reserves etc.
- 7) Net worth = Shareholders funds - Fictitious Assets
- 8) Capital employed = Networth + Longterm Liabilities.
- 9) Equity shareholders funds = Shareholders funds - P. Share capital
- 10) Net working capital = Current Assets - Current Liabilities
- 11) Gross working capital = Total of current Assets.
- 12) Net Sales = Total Sales - Sales Returns.

Sl.No	Category	Ratio	Formulae
1.	Leverage Ratio	Debt Equity Ratio (DER) = $\frac{\text{Longterm liabilities}}{\text{Shareholders funds}}$	
2.		Proprietary Ratio (PR) = $\frac{\text{Networth}}{\text{Total Assets}}$	
		Fixed Assets Ratio (FAR) = $\frac{\text{Fixed Assets}}{\text{capital employed}}$	
2.	Liquidity Ratio	Current Ratio - (C.R) = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$	
		Quick Ratio (Q.R) = $\frac{\text{Quick Assets}}{\text{Current Liabilities}}$ (liquid ratio)	
3.	Profitability Ratios	Gross profit Ratio (GPR) = $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$	
		Net Profit Ratio (NPR) = $\frac{\text{Net profit after tax}}{\text{Net Sales}} \times 100$	
4.	Turnover Ratio	Gross working capital (GWC) = Total of current assets	
		Net working capital (NWC) = [Current Assets - Current liabilities]	
		Gross profit = Sales - COGS (cost of goods sold)	
		Cost of goods sold = Net Sales - G. Profit	

Illustration :-

The following data is extracted from the financial statements of a concern dealing in chemicals compute :-

- (a) Gross working capital
- (b) Net working capital
- (c) Current Ratio / Working capital ratio.
- (d) Quick Ratio / Liquidity Ratio.

Given information is that :

1) Sundry creditors	→	£ 1,00,000/-
2) Bills payable	→	20,000/-
3) Bank overdraft	→	25,000/-
4) Salaries outstanding	→	5,000/-
5) Sundry Debtors	→	1,75,000/-
6) Bills Receivable	→	35,000/-
7) Cash & Bank balance	→	40,000/-
8) Closing stock	→	48,000/-
9) Prepaid Insurance	→	2,000/-

Solution :-

(a) Gross working capital = Total of current Assets.
= £ 3,00,000/-

Now :-

$$\begin{aligned}
 \text{Current Assets} &= \text{Debtors} + \text{B/R} + \text{Cash \& Bank balance} \\
 &\quad + \text{Closing Stock} + \text{Prepaid Insurance} \\
 &= 1,75,000 + 35,000 + 40,000 + 48,000 \\
 &\quad + 2,000 = \boxed{3,00,000}
 \end{aligned}$$

The following data is extracted from the financial statements of a concern dealing in chemicals compute :-

- Gross working Capital
- Net working Capital
- Current Ratio / working capital ratio.
- Quick Ratio / Liquidity Ratio.

Given information is that :

1) Sundry creditors	→	Rs 1,00,000/-
2) Bills payable	→	20,000/-
3) Bank overdraft	→	25,000/-
4) Salaries outstanding	→	5,000/-
5) Sundry Debtors	→	1,75,000/-
6) Bills Receivable	→	35,000/-
7) Cash & Bank balance	→	40,000/-
8) Closing stock	→	48,000/-
9) Prepaid Insurance	→	2000/-

Solution

$$(a) \text{ Gross working capital} = \text{Total of current Assets.} \\ = \text{Rs } 3,00,000/-$$

Now

$$\begin{aligned} \text{Current Assets} &= \text{Debtors} + \text{B/R} + \text{Cash \& Bank balance} \\ &\quad + \text{Closing Stock} + \text{Prepaid Insurance} \\ &= 1,75,000 + 35,000 + 40,000 + 48,000 \\ &\quad + 2000 = \boxed{3,00,000} \end{aligned}$$

Problems:-

From the following balances of Mrs. Krishna & Co,
Prepare Trading a/c for the year ended 31 March 2007.

Opening stock 1/4/2006 — 12,000.

Purchases — 28,000

Carriage inwards — 200

Sales returns — 1,200.

Purchase returns — 1,200

Sales — 40,000.

Wages — 1,500.

closing stock 31/3/2007 — 14,000.

sol
Trading a/c of Mrs. Krishna & Co

Dr			for the year ending 31.3.2007.			Cr		
Particulars	Amount (Rs)	Amount (Rs)	Particulars	Amount (Rs)	Amount (Rs)			
To opening stock		12,000	By Sales	40,000				
TO purchases	28,000		↳ Sales returns	1,200	38,800			
↳ P. Returns	(1,200)	26,800	By closing stock		14,000			
TO Wages		1,500						
TO Carriage inwards		200						
TO Gross profit (B/P)		12,300						
(Transferred to P&L a/c)								
		52,800			52,800			

2) From the following balance, prepare P&L ac for Mr. Dinesh for the year ending 31.12.2007.

Gross profit - 25,000
Stationery - 375
Printing - 75
Rent - 650
Int. on. loan - 225
Repairs - 125
Office lighting - 55
General Expenses - 875

Postage - 175
Salaries - 5,600
Insurance - 200
Discount - 400
Dis. Received - 300
Commission earned - 100
Advertisement - 450
Taxes - 150
Travelling Exp. - 500

89/11

Cr

P & L ac for the year ending 31/12/07 in the books of Mr. Dinesh

Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)	Amt (Rs)
TO Stationery		375	By Gross profit		25,000
TO Printing		75	By commission earned		100
TO Rent		650	By Discount Received		300
TO Int. on. loans		225			
TO Repairs		125			
TO Office lighting		55			
TO General Exp.		875			
TO Postage		175			
TO Salaries		5,600			
TO Insurance		200			
TO Discount		400			
TO Advertisement		450			
TO Taxes		150			
TO Travelling Exp.		500			
TO Net profit (B/f) c/d (Transferred to B/sheet)		15,545*			25,400
		25,400			

3) From the following Balances of Mr. Menon - prepare Final Account with closing stock of Rs 10,000 as on 31.12.2007.

Purchases - 42,000

Loan on mortgage - 30,000.

Wages - 30,000.

Salaries - 7,200

Bills payable - 4,000.

Loose tools - 700.

Cash in hand - 1,000

Stationaries - 1,200.

Capital - 40,000.

Rent - 650.

Office Expenses - 700.

Sales - 96,400.

Creditors - 10,000.

Bills Receivables - 3,000.

Cash at Bank - 2,000.

Debtors - 40,000

Machinery - 20,000.

Insurance - 150

Land - 30,000.

Interest - 1,500.

Sol Trading and Profit & Loss a/c of Mr. Menon
for the year ended 31.12.2007.

Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)	Amt (Rs)
TO Purchases		42,000	By Sales		96,400
TO Wages		30,000	By closing stock		10,000
TO Gross profit b/d (B/f)		34,400			
(Transfer to P/L a/c)		1,06,400			1,06,400
TO Salaries		7,200	By Gross profit b/d		34,400
TO Stationery		1,200			
TO Rent		650			
TO Office Expenses		700			
TO Insurance		150			
TO Interest		1,500			
TO Net profit b/d (B/f)		23,000			
(Transferred to B/sheet)		23,000			
		34,400			34,400

FINAL ACCOUNTS WITH ADJUSTMENTS

FINAL ACCOUNTS :-

After preparing the trail balance only, it is possible to prepare final Accounts. The final accounts are prepared to know the progress of Biz, or profit or loss, financial soundness of the firm at right time and right way. The final account consists of

- Trading alc
- Profit & loss alc.
- Balance sheet.

Trading & profit & loss alc are prepared to find out profit / loss.

Balance sheet is prepared to know the financial position of the organisation at a particular date.

In a biz, the Expenditure are classified into direct expenditure and indirect expenditure. All the direct exp. are debited into the debit side of the Trading alc and all the direct incomes are credited in the credit side of trading alc.

If we balance the trading alc, the balance is in the debit side means, the business is getting profit and named as "Gross profit". The balance is in the credit side and it shows loss and it is called "Gross loss".

Gross profit is transferred to the credit side of P&L alc. If it is loss, it is transferred to the Debit side of P&L alc.

Profit and Loss a/c :-

All the indirect Expenses are debited in the P&L a/c. Indirect Expenses are in the following heads.

- Selling Expenses.
- Office Expenses.
- Maintenance Expenses.
- Financial Expenses.

All the Indirect Incomes like Discount Received, commission received are credited to the P&L a/c.

If the balance is in debit side, called Net profit,

If the balance is in credit side, called Net loss.

The Net profit is transferred to Balance sheet liability side and added to capital.

If it is Net loss, it will be deducted from

Capital.

Specimen form of Trading a/c.

Dr Trading a/c for the year ended x x x					
Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)	Cr Amt (Rs)
To Opening stock		x x x	By Sales	x x x	
To Purchases	x x x		(-) Sales returns (Return inwards)	(x x x)	x x x
(-) Purchase returns (Return outwards)	(x x x)	x x x	By closing stock		x x x
To Wages		x x x	By Gross loss c/d (B/F)		[x x x]
To Freight		x x x	[Transferred to P&L a/c]		
To Carriage inwards		x x x			
To Clearing charges		x x x			
To Packing charges		x x x			
To Power		x x x			
To Gross profit c/d (B/F)		[x x x]			
[Transferred to P&L a/c]		x x x			x x x

Specimen of P & L a/c

Dr P & L a/c for the year ended x x x					
Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)	Cr Amt (Rs)
To Gross loss b/d		x x x x	By Gross profit b/d		x x x x
To Salaries		x x x	By Commission received/earned		x x x
To Rent & Taxes		x x x	By Rent received		x x x
To Stationary		x x x	By Interest received		x x x
To Postage Expenses		x x x	By Discount received		x x x
To Insurance		x x x			

[Continued]

Dr					Cr
Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)	Amt (Rs)
To Repairs		x x x	By Net loss l/d		[x x x x]
To Trading Exp		x x x	[B/F]		
To office Exp		x x x	[Transferred to		
To Interest		x x x	Capital a/c]		
To Bank charges		x x x			
To Establishment Expenses		x x x			
To Sundry Expenses		x x x			
To Commission allowed		x x x			
To Discount allowed		x x x			
To Advertisement		x x x			
To Carriage outwards		x x x			
To Travelling Expenses		x x x			
To Distribution Expenses		x x x			
To Bad debts		x x x			
To Depreciation		x x x			
To Bad debts provision		x x x			
To Net profit (l/d)		[x x x x]			
[B/F]		£			
[Transferred to capital a/c]					
		x x x x			x x x x

as on 31.12.2004.					
Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	40,000		Loose tools		1,000
(+) Net profit	23,000	63,000	Cash in hand		1,000
creditors		10,000	Bills Receivables		3,000
Bills payable		4,000	Cash at Bank		2,000
Loan on Mortgage		30,000	Debtors		40,000
			Machinery		20,000
			Land		30,000
			closing stock		10,000
		1,07,000			1,07,000

Preparation of Final Accounts with Adjustments.

We are preparing the Trading a/c, P&L a/c is prepared to know the profit or loss for the a given period. The purpose of Balance sheet is to know the financial position at a given period, so to get a fair and true view of business, the real profit or loss can be arrived after taking all adjustments.

The common adjustments are:-

- 1) closing stock
- 2) outstanding Expenses.
- 3) Prepaid Expenses
- 4) Accrued Incomes
- 5) Incomes received in Advance

- 6) Interest on Capital
- 7) Interest on Drawings
- 8) Interest on Loans
- 9) Depreciation
- 10) Bad debts
- 11) Provision for Bad & Doubtful debts.
- 12) Provision for Discount on Debtors.
- 13) Provision for Discount on Creditors.

While preparing final a/c's, the above adjustments are taken into account. All the adjustments are given outside the Trial Balance. All the adjustments will appear at two places in the final a/c's.

- 1) Trading a/c & Balance sheet
- 2) ~~Balance Sheet~~ Balance sheet.

Illustration-2

The following are the Balances extracted from the books of Narendra Sharma & Co on 31/12/2008.
Prepare Trading a/c, P&L a/c and Balance Sheet after considering the adjustments given below.

Sales - 1,50,000.
Capital Bal- 35,000.
Drawings - 6,000
Furniture - 2,600
Bank O.D - 4,200
Sundry creditors - 13,800.
Business premises - 24,000
Stock (1/1/08) - 20,000
Debtors - 15,000
Bad debts - 800

Sales returns - 2000.
Rent from Tenants - 1000.
Purchases - 1,12,000.
Taxes & Insurance - 2000.
General Expenses - 4000.
Salaries - 12,000.
Commission (Dr) - 1,600
Carriage - 2000.
Discount (Dr) - 2000
Discount (Cr) - 2000.

Adjustments :-

- 1) Stock on hand on 31.12.2008 — 20,000.
- 2) Written off Depreciation on Business premises — 1000,
Furniture — 600.
- 3) Make a reserve of 5% on Debtors for doubtful debts.
- 4) Allow int. on capital at 5%.
- 5) Carry forward 200 for unexpired Insurance.

Dr Trading, P&L A/c of Narendra Sharma as on 31/12/08 Cr					
Particulars	Amount (Rs)	Amount (Rs)	Particulars	Amount (Rs)	Amount (Rs)
To Opening stock		20,000	By Sales	1,50,000	
To Purchases		1,12,000	By Sales Returns	2,000	1,48,000
To Carriage		2,000	By closing stock		20,000
To Gross profit b/d [Transferred to P&L A/c]		34,000			
		1,68,000			1,68,000
To General Expenses		4,000	By Gross profit b/d		34,000
To Salary		12,000	By Discount received (Cr)		2,000
To Commission		1,600	By Rent from tenants		1,000
To Discount (Dr)		2,000			
To Depreciation on premises		1,000			
To Depreciation on Furniture		600			
To Reserve for doubtful debts. [15,000 × 5/100] (5%)		750			
To Int. on capital [35,000 × 5/100]		1,750			

TO Bad debts		800		
TO Taxes & Insurance	2000			
(-) unexpired "	(200)	1800		
TO Net profit cl		1,0700		
(Transferred to capital ac				
		37000		37,000

Balance sheet of Mr. Narendra Sharma

as on 31/12/2008

Liabilities	Amt (Rs)	Amt (Rs)	Assets	Amt (Rs)	Amt (Rs)
Capital	35,000		Stock on hand		20,000
(+) Net profit	10,700		Business premises	24,000	
(+) Int. on capital	1,750		(-) Depreciation	(1,000)	23,000
	47,450		Furniture	2,600	
(-) Drawings	(6000)	41,450	(-) Depreciation	(600)	2,000
Bank overdraft		4,200	Debtors	15,000	
Creditors		13,800	(-) Reserve on doubtful debts	(750)	14,250
			unexpired Insurance		200
		59,450			59,450

Treatment for Adjustments :-

- 1) Stock on hand Rs 20,000 $\left\{ \begin{array}{l} \text{Trading a/c} \rightarrow \text{Cr.} \\ \text{Balance sheet} \rightarrow \text{A} \end{array} \right.$

- 2) a) Depreciation on premises 1000 $\left\{ \begin{array}{l} \text{P\&L a/c} \rightarrow \text{Dr} \\ \text{Balance sheet} \rightarrow \text{A.} \end{array} \right.$
Deduct from concerned Asset in B/sheet.
- b) Depreciation on Furniture - 600 $\left\{ \begin{array}{l} \text{P\&L a/c} \rightarrow \text{Dr} \\ \text{B/sheet} \rightarrow \text{A.} \end{array} \right.$
Deduct from concerned Asset in B/sheet.

- 3) Reserve for doubtful debts of 5% on Debts - 450 $\left\{ \begin{array}{l} \text{P\&L a/c} \rightarrow \text{Dr} \\ \text{Balancesheet} \rightarrow \text{A} \end{array} \right.$
Deduct it from Debts in Assets side.

- 4) Allow 5% int. on Capital - 1750 $\left\{ \begin{array}{l} \text{P\&L a/c} \rightarrow \text{Dr} \\ \text{Balance sheet} \rightarrow \text{L.} \end{array} \right.$
Add with capital in Liabilities side of B/sheet.

- 5) unexpired Insurance 200 $\left\{ \begin{array}{l} \text{P\&L a/c} \rightarrow \text{Dr} \\ \text{B/sheet} \rightarrow \text{A.} \end{array} \right.$

Adjustments :-

- 1) Closing Inventory - 8000/-
- 2) Depreciation on plant & Machinery at 15% and 10% on Buildings.
- 3) Provision for doubtful receivables 500/-
- 4) Insurance prepaid - 50/-
- 5) Outstanding Rent - 100/-

Trading and Profit & loss a/c Mrs. Sunshine

Dr		as on 31.12.2008.		Cr	
Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Opening stock		6,000	By Sales		35,000
To Purchases	18,000		By closing stock		8,000
Cr) P. Returns	(2,000)	16,000			
To Wages		7,000			
To Freight		200			
To Gross profit		13,800			
[Transferred to P&L a/c]					
		43,000			43,000

(P.T.O)

Illustration - II.

Mrs. Sunshine & Co Trial Balance as on 31/12/2008

Particulars	Debit	Credit
Capital	—	25,000
Loans	—	5,000
Sales	—	35,000
A/c's payable (creditors)	—	4,000
Bills payable	—	5,000
Purchase Returns	—	2,000
Dividends Received	—	3,000
* Plant & Machinery	13,000	—
* Buildings	17,000	—
* Receivables	9,650	—
Purchases	18,000	—
Discount allowed	1,200	—
Wages	7,000	—
Salaries	3,000	—
Travelling Expenses	750	—
Freight	200	—
* Insurance	300	—
Commission paid	100	—
Bank	17,000	—
Repairs	500	—
Int on loans	600	—
Opening Inventories	6,000	—
Total	79,000	79,000

Dr		P&L a/c		Cr
Particulars	Amt (Rs)	Amt (Rs)	Particulars	Amt (Rs)
TO Depreciation on Machinery (13000 X 15/100)		1,950	By Gross profit b/d	13,800
TO Depreciation on Buildings (17000 X 10/100)		1,700	By Dividends received	3,000
TO Provision for doubtful debts		500		
TO Insurance less: Prepaid	300 (50)	250		
TO Outstanding rent		100		
TO Discount allowed		1,200		
TO Salary		3,000		
TO Travelling Expenses		750		
TO Commission paid		100		
TO Repairs		500		
TO Interest on loan		600		
TO Net profit c/d (Transferred to Capital a/c)		6,150		
		16,800		16,800

Balance Sheet of Mrs. Sunshine as on 31/12/2008

Liability	Amt	Amt	Assets	Amt	Amt
Capital	25,000		Plant & Machinery	13,000	
(+) Net profit	6,150	31,150	(-) Depreciation	1,950	11,050
Loans		5,000	Buildings	17,000	
Creditors		4,000	(-) Depreciation	1,700	15,300
Bills payable		5,000	Prepaid Insurance		50
Outstanding Rent		100	Bank		1,700
			Receivables	9,650	
			(-) Provision for D.D (500)		9,150
			Closing stock		8,000
		45,250			45,250

THE END