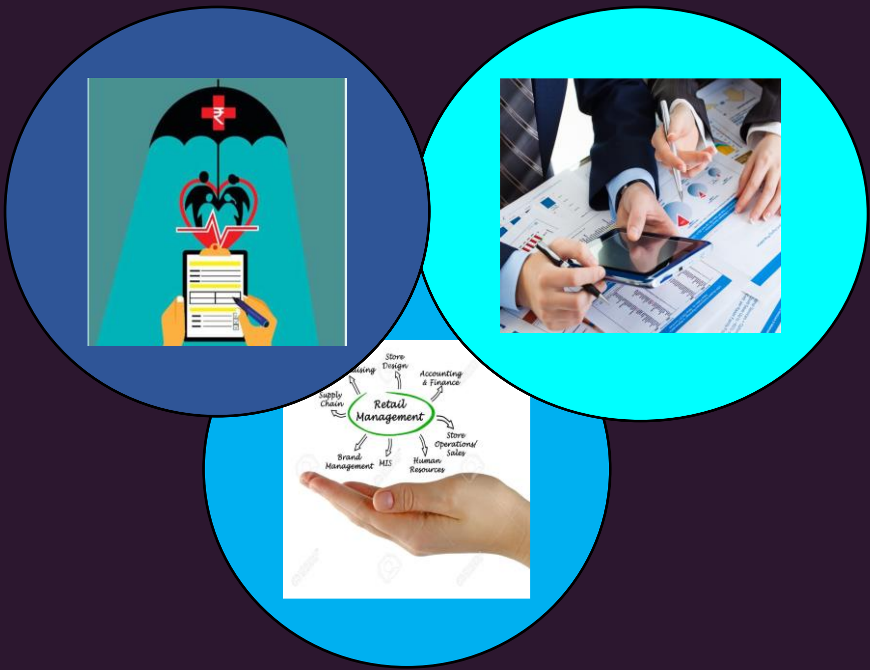
INTERMEDIATE VOCATIONAL
SECOND YEAR TEXT BOOK

BANKING AND RETAIL MANAGEMENT



- Banking and Insurance – II
- Business Accountancy – II
- Retail Management

BOARD OF INTERMEDIATE EDUCATION,
VIJAYAWADA, ANDHRA PRADESH.

BANKING AND RETAIL MANAGEMENT (BRM)

SECOND YEAR

(w.e.f. 2021 – 22)

Intermediate Vocational Course

Paper I: **Banking & Insurance - II**

Paper II: **Business Accountancy - II**

Paper III: **Retail Management**

STATE INSTITUTE OF VOCATIONAL EDUCATION

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BANKING AND RETAIL MANAGEMENT (BRM)

SECOND YEAR PAPER – I

BANKING & INSURANCE – II

INDEX

UNIT - I
INDIAN MONEY MARKET

Indian Money Market - Characteristics, Structure, composition (call and notice, money market, treasury bills market, CDs, CPs, short term bill market, MMMFs and DFHI).

Learning Objectives:

After studying this unit, the student will be able to

- Understand about the structure of Indian Money Market
- Understand about the components of Money Market
- Understand the Characteristics of Indian Money Market

1.0. Introduction:

In an economy, there are various forms of market. One such form is the financial market, a place where financial assets are created and exchanged. This financial market has two major classifications – capital market and money market.

Money Market is a segment of the financial market in India where borrowing and lending of short-term funds take place. The maturity of money market instruments is from one day to one year. In India, this market is regulated by both RBI and SEBI. The nature of transactions in this market is such that they are large in amount and high in volume. Thus, we can say that the entire market is dominated by a small number of large players.

Money market is a market for dealing with financial assets and securities which have a maturity period of up to one year. In other words, it is a market for purely short-term funds.

1.1. Characteristic Features of Indian Money Market: The following are the important features of the money market in India.

i. The money market is purely for short-term funds or assets called near money.
ii. All the instruments of the money market deal only with financial assets that are financial in nature. Also, such instruments have maturity period up to one year.
iii. It deals assets that can convert into cash readily without much loss and with

minimum transaction cost.

iv. Generally, transactions take place through oral communication (for e.g., phone or mobile). The exchange of relevant documents and written communications take place subsequently. There is no formal place for the trading (like a stock exchange).

v. Transactions can be conducted without the help of brokers.

vi. The components of a money market are the Central Bank, Commercial Banks, Non-banking financial companies, discount houses, and acceptance house. Commercial banks are dominant player of this market.

1.2. Objectives of Money Market: Following are the objectives of money market:

i. To cater to the requirements of borrowers for short term funds, and provide liquidity to the lenders of these funds.

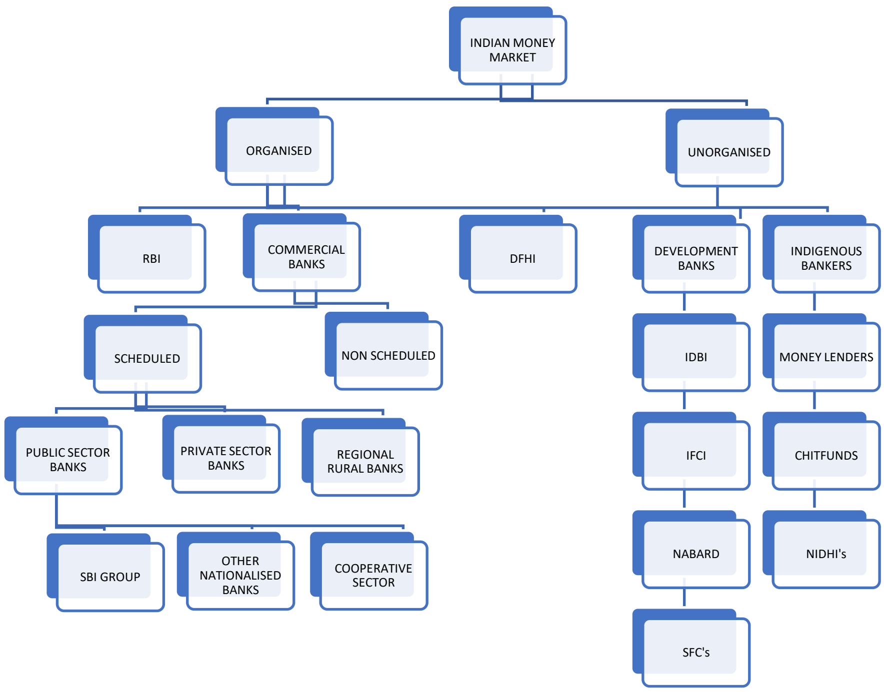
ii. To provide parking place for temporary employment of surplus fund.

iii. To provide facility to overcome short term deficits.

iv. To enable the central bank to influence and regulate liquidity in the economy.

v. To help the government to implement its monetary policy through open market operation.

1.3. Structure of Indian Money Market:



The Indian Money Market consists of both Organised and unorganized segment. The Organised segment includes the Reserve Bank of India, State Bank of India, Public Sector as well as Private Sector Banks, Regional Rural Bank, Commercial Banks including Foreign Banks, Non-Scheduled Commercial Banks and other Non-Bank Financial Intermediaries such as LIC, GIC, and UTI etc. On the other hand, the unorganized segment consists of indigenous bankers, money lenders and other non-bank financial intermediaries.

The money market may be subdivided into four. They are:

a) Call money market
b) Commercial bills market
c) Treasury bills market
d) Short term loan market

a) **Call Money Market:** The call money market is a market for extremely short period loans say one day to fourteen days. So, it is highly liquid. The loans are repayable on demand at the option of either the lender or the borrower. In India, call money markets are associated with the presence of stock exchanges and hence, they are located in major industrial towns like Bombay, Calcutta, Madras, Delhi, Ahmadabad etc. The special feature of this market is that the interest rate varies from day to day and even from hour to hour and centre to centre. It is very sensitive to changes in demand and supply of call loans.

b) **Commercial Bills Market:** It is a market for bills of exchange arising out of genuine trade transactions. In the case of credit sale, the seller may draw a bill of exchange on the buyer. The buyer accepts such a bill promising to pay at a later date specified in the bill. The seller need not wait until the due date of the bill. Instead, he can get immediate payment by discounting the bill.

   In India the bill market is under-developed. The RBI has taken many steps to develop a sound bill market. The RBI has enlarged the list of participants in the bill market. The Discount and Finance House of India was set up in 1988 to promote secondary market in bills. In spite of all these, the growth of the bill market is slow in India. There are no specialized agencies for discounting bills. The commercial banks play a significant role in this market.

c) Treasury Bills Market: It is a market for treasury bills which have 'short-term' maturity. A treasury bill i a promissory note of a finance bill issued by the Government. It is highly liquid because its repayment is guarantee by the Government. It is an important instrument for short-term borrowing of the Government.

There are two types of treasury bills namely:

(i) ordinary or regular and
(ii) adhoc

Ordinary treasury bills are issued to the public, banks and other financial institutions with a view to raising resources for the Central Government to meet its short-term financial needs.

treasury bills popularly known as 'adhocs'. Adhoc treasury bills are issued in favour of the RBI only. They are not sold through tender or auction. They can be purchased by the RBI only. Adhocs are not marketable in India but holders of these bills can sell them back to 364 days only. Financial intermediaries can park their temporary surpluses in these instruments and earn income.

d) Short-Term Loan Market: It is a market where short-term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play a significant role in this market. Commercial banks provide short term loans in the form of cash credit and overdraft. Overdraft facility is mainly given to business people whereas cash credit is given to industrialists. Overdraft is purely a temporary accommodation and it is given in the current account itself. But cash credit is for a period of one year and it is sanctioned in a separate account.

Certificate of Deposits (CDs): The certificate of deposits is issued by commercial banks. They are worth the value of Rs. 25 lakhs and in multiple of Rs. 25 lakhs. The minimum subscription of CD should be worth Rs. 1 Crore. The maturity period of CD is as low as 3 months and as high as 1 year. These are the transferable investment instrument in a money market. The government initiated a market of CDs in order to widen the range of instruments in the money market and to provide a higher flexibility to investors for investing their short-term money.

Commercial Papers (CPs): Commercial paper is an investment instrument which can be issued by a listed company having working capital more than or equal to Rs. 5 crores. The CPs can be issued in multiples of Rs. 25 lakhs. However, the minimum subscription should at least be Rs. 1 cr. The maturity period for the CP is of minimum 3 months and maximum 6 months. This was introduced by the government in 1990.

Money Market Mutual Funds (MMMFs): The money-market mutual funds were introduced by RBI in 1992 and since 2000 they are brought under the regulation of SEBI. It is an open-ended mutual fund which invests in short-term debt securities. This kind of mutual fund solely invests in instruments of the money market.

Discount and Finance House of India (the DFHI): The RBI establishes DFHI in 1988. RBI, Public Sectors Banks, and other Indian financial institutions jointly own DFHI. The DFHI paid-up capital consists of the contribution of these institutions jointly. DFHI plays an important role in developing an active secondary market. It deals in T-Bills, Commercial bills, CDs, CPs, call money market, and government securities.

Short Answer Questions (2 Marks)

1. What is Indian Money Market?
2. What is Call Money Market?
3. What is DFHI?
4. What is MMMF's?
5. What is Treasury Bill Market?

Essay Answer Questions (6 Marks)

1. What are the Characteristic Features of Indian Money Market?
2. Write the structure of Indian Money Market?
3. What are the Objectives of Money Market?

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UNIT - II

COMMERCIAL BANKS DEPOSIT ACCOUNTS

Types of Deposit Accounts- Fixed deposits, Savings bank deposit - Basic Savings Bank Deposit Account - Current Account - Pradhan Mantri Jan-Dhan Yojana (PMJDY) Account. Procedure for opening of Deposit accounts.

Learning Objectives:

After studying this unit, the student will be able to

- Understand about various types of deposit accounts
- Understand about the procedure for opening of deposit accounts

1.1. Deposit Accounts: A deposit account is a type of bank account that allows money to be deposited and withdrawn by the account holder. Deposit accounts are divided into **two** categories:

A. Time deposits.
B. Demand deposits

Time deposits further classified into **two**:

i. Fixed deposits; and
ii. Recurring deposits.

Similarly, the **two** categories of Demand deposits are:

i. Savings account; and
ii. Current account.

i. Fixed Deposits: Fixed deposits refer to the deposits repayable after the expiry of a certain period, which generally varies from 3 months to 5 years or more. The fixing of the period enables the banker to invest money without having to keep a reserve and hence is very popular with the bank. This type of deposit account allows the deposit to be made of an amount for a specified period. The interest on fixed deposit account can be withdrawn at certain intervals of time. At the end of the period, the deposit may be withdrawn or renewed for a further period. Banks also grant a loan on the security of fixed deposit receipt.

ii. Recurring Deposits: Recurring Deposits (RD) provides customers with the flexibility to invest an amount of their choice each month and save money with ease. Recurring deposit accounts are offered by most of the banks and NBFCs in India with tenures ranging from 6 months to 10 years. The interest rate usually ranges from 5.00% - 7.85%.

iii. **Savings Deposits:** Savings deposits are subject to restrictions on the number of withdrawals as well as on the amounts of withdrawals during any specified period. Further, minimum balances may be prescribed in order to offset the cost of maintaining and servicing such deposits. Savings deposits are deposits that accrue interest at a fixed rate set by the commercial banks.

iv. **Current Accounts:** A current account is a type of bank account which allows the user to carry out a significantly high number of transactions. The money in this account is always available for immediate access and is usually operated by business individuals, proprietary concerns, public and private companies, associations, trusts, etc. who have reasons to make frequent and high-volume transactions with their banks.

v. **Basic Savings Bank Deposit Account (BSBD Account):** This account can be opened by any individual provided he/she has valid KYC documents. Primarily meant for poorer sections of society to encourage them to start saving without any burden of charges or fees.

Features:

- Available at all branches
- Minimum balance amount Nil
- Maximum balance /amount No upper limit
- No Cheque Book facility available.
- Withdrawals only using withdrawal form at Branches or through ATMs.
- Basic RuPay ATM-cum-debit card will be issued.

vi. **PMJDY Account**: Pradhan Mantri Jan-Dhan Yojana (PMJDY) is National Mission for Financial Inclusion to ensure access to financial services, namely, a basic savings & deposit accounts, remittance, credit, insurance, pension in an affordable manner. Under the scheme, a basic savings bank deposit

(BSBD) account can be opened in any bank branch or Business Correspondent (Bank Mitra) outlet, by persons not having any other account.

Benefits under PMJDY:

a. One basic savings bank account is opened for unbanked person.
b. There is no requirement to maintain any minimum balance in PMJDY accounts.
c. Interest is earned on the deposit in PMJDY accounts.
d. RuPay Debit card is provided to PMJDY account holder.
e. Accident Insurance Cover of Rs.1 lakh (enhanced to Rs. 2 lakhs to new PMJDY accounts opened after 28.8.2018) is available with RuPay card issued to the PMJDY account holders.
f. An overdraft (OD) facility up to Rs. 10,000 to eligible account holders is available.
g. PMJDY accounts are eligible for Direct Benefit Transfer (DBT), Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY), Micro Units Development & Refinance Agency Bank (MUDRA) scheme.

1.2. Term Deposit Features:

- Payment of interest at Monthly/Quarterly/Calendar quarter basis as per your requirement.
- Payment of Monthly interest will be at discounted rate. Interest will be paid at the contracted rate irrespective of change in the rates thereafter.
- Senior Citizens get 0.25% extra interest rate for amount above Rs 10,000/-
- Tenure: 7 days to 10 years.
- Minimum Deposit is Rs.1000/-
- Maximum Deposit: No Limit
- Loans / OD up to 90% of the Principal deposit. For details click here: Loan Against Time Deposit
- Nomination facility available
- Premature Withdrawal w.e.f. 01.04.2017 is Available.

1.2.1. Savings Bank Account Features:

- Mobile banking

- SMS Alerts
- Inter-Net banking
- First 10 cheque leaves free in a financial year
- Restricted free withdrawals based on Monthly Average Balance maintained
- The facility of transfer of accounts through Internet Banking channel
- Nomination facility is Available
- Monthly Average Balance: NIL
- No limit on Maximum balance
- A Pass Book is issued to record the transactions. Duplicate pass book can be issued if original is lost, on payment of charges. Statement of accounts can also be sent through e-mail.

1.2.2. **Current Account Features**:

- Allows for prompt business transactions.
- No limit on withdrawals.
- No limit on deposits in the home branch.
- Enables businessmen to make direct payments using cheques, demand drafts, or pay orders.
- Provides overdraft facility.
- Provides internet banking and mobile banking facilities.

1.2.3. **Recurring Deposit Features**:

- Recurring Deposit schemes aim to inculcate a regular habit of saving among the public.
- Minimum amount that can be deposited varies from bank to bank. It can be an amount as small as Rs.10.
- The minimum period of deposit starts at six months and the maximum period of deposit is ten years.
- The rate of interest is equal to that offered for a Fixed Deposit and is hence higher than any other Savings scheme.
- Premature and midterm withdrawals are not allowed. However, the bank may allow to close the account before the maturity period, sometimes with

a penalty for premature withdrawal.

- RD offers the additional benefit of taking loan against the deposit, i.e., by using the deposit as a collateral. About 80 to 90% of the deposit value can be given as loan to the account holder.
- The Recurring Deposit can be funded periodically through Standing Instructions which are the instructions given by the customer to the bank to credit the Recurring Deposit account every month from his/her Savings or Current account.

1.3. Procedure for Opening of Deposit Accounts:

1.3.1. Fixed Deposit Opening Procedure:

1.3.1. Fixed Deposit Opening Procedure: You can open a fixed deposit account both offline and online.

i. Fixed Deposit Account Opening Procedure (Online):

- Log-in to net banking by providing personal details.
- From fixed deposit option, click on e-TDR/e-STDR (FD). Now, click on proceed. TDR is term deposit, while STDR is Special Term Deposit.
- Proceed to choose the type of FD you want to open and click ‘Proceed’.
- If you have multiple bank accounts, then choose the account from which money has to be debited.
- Also choose the FD principal value and fill the same in the ‘Amount’ column.
- Now, choose the tenure of deposit— days, year/months/days or maturity date.
- Now choose maturity instruction for your term deposit account.
- Click on terms and conditions and then submit.
- Your FD with details (name, nominee etc) will appear on the screen. Click 'OK'.
- Please note the transaction number for future reference. You can take out a print or save as a PDF by clicking on the respective options.

ii. Fixed Deposit Account Opening Procedure (Offline):

Opening an FD account offline is similar to opening a saving account. You have to follow these steps.

If already have an Account in the chosen Bank:

- Go to the branch and ask for FD Account opening form.
- Fill all the details and sign the form.
- Come back again after 2-3 days to collect FD advice.

If you are Going To new Bank:

- Carry ID proof, address proof, PAN, Photograph, cheque or cash to the bank. Carry documents in original and copy as well.
- Ask for Account opening form and fill it. Paste the photograph.
- Attach the signed copy of PAN, ID proof and address proof.
- Submit the form along with the cheque. If you are giving cash, you have to deposit cash at the cash counter.

1.3.2. Savings Bank Account Opening Procedure:

i. **Online Process**: The basic steps are as follow:

- Visit the bank's website.
- Login into the account or initiate the online process to open the savings account provided on the official website.
- Fill in the application form and enter your name, address, date of birth and other various details.
- Provide all the relevant Savings Account documents which include Aadhar, Voter ID, PAN Card or any other relevant document which fulfils the KYC requirements.
- On submission of the documents, the bank or financial institution will initiate the verification process.
- If all the documents and information is authentic approval will be granted, the account will be activated within 3-5 working days.

ii. **Offline**: The steps to open a saving bank account at the branch are as follow:

- Visit the bank where you want to open the savings account.
- Fill the account opening form and make sure that you check all the information provided. The information in the forms must match the information in the KYC documents.

- Submit the form and the KYC documents.
- To open an account, you will be required to make an initial deposit of a certain amount and this amount differs from bank to bank.
- After the completion of the verification, you will be provided with the cheque book, passbook and other relevant documents related to the savings account.

1.3.3. Recurring Deposit Account Opening Procedure:

i. Online:

- To apply for RD through Online, you have to activate your Net Banking.
- Go to the official website of the corresponding bank.
- Log in with your name or ID and password.
- Search for the Recurring Deposit Account Opening.
- If you find the account opening link, then click on it.
- The RD Account opening page appears on the screen.
- Enter the necessary details like deposit amount, tenure period, interest rate, etc.,
  as per the corresponding columns necessity.
- After filling all the details link your savings account to the RD Account.
- Your online Recurring Deposit Account opening is completed by following the
  above steps.

ii. Offline:

- Go to the corresponding bank and take the RD Application Form.
- Fill the form completely without any mistakes.
- Put signature in the required places.
- Attach the required documents list to the application form.
- Submit it to banks.
- Your Offline account opening process is completed till now.

Short Answer Questions (2 Marks)

1. How many types of Bank Deposits? What are they?
2. What is Fixed Deposit?
3. What is Savings Deposit?
4. What is Current Deposit?
5. What is Recurring Deposit?
6. What is Basic Savings Bank Deposit Account?
7. What is PMJDY Account?

Essay Answer Questions (6 Marks)

1. Explain briefly about various types of Deposit Accounts?
2. What are the features of the Fixed Deposit?
3. What are the features of the Savings Bank Account?
4. What are the features of the Current Account?
5. What is the procedure for opening of Fixed Deposit Account?
6. What is the procedure for opening of Savings Account?
7. What is the procedure for opening of Recurring Deposit Account?
8. What are the Benefits of PMJDY Account?

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UNIT - III

LOANS AND ADVANCES

Meaning of Term loan - Considerations for Grant of Loans - Types of Loans: Cash credits, Overdrafts, Bill's discounting - Consortium finance – Non-Preforming Assets (NPAs). Retail Loans: Gold loans - Housing loans - Personal loans - Educational Loans-Vehicle loans - Real Estate and Mortgage loans – Modes of charging securities against Loans: Lean, Pledge, Hypothecation, Mortgage.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand About Meaning and Considerations for Granting Loans and Advances
- ☞ Understands About Various Types of Loans
- ☞ Understand About the Concept of Non-Performing Assets

1. **Introduction:** In the previous unit, we dealt with the various types of deposit accounts including no-frills accounts. This unit will help you to understand the various aspects related to loans and advances. The various section and sub section of this unit will also summarize the concept of evaluating consumer and commercial loans. Efficient management of Loans and Advances portfolio has assumed greater significance as it is the largest asset of the bank having direct impact on its profitability. In the wake of the continued tightening of norms of income recognition, asset classification and provisioning, increased competition and emergence of new types of risks in the financial sector, it has become imperative that the credit functions are strengthened. RBI has also been emphasizing banks to evolve suitable guidelines for effective management and control of credit risks.

1.1. **Term Loans** (**Outright Loans**) – Meaning: - A term loan is a loan from a bank for a specific amount that has a specified repayment schedule and either a fixed or floating interest rate. A term loan is often appropriate for an established small business with sound financial statements and the ability to make a substantial down payment to minimize payment amounts and the total cost of the loan.

Banks provide outright loans for a fixed period. The borrower pays interest on the entire amount he has borrowed.

- Term loans are the opposite of fixed deposits in the bank. The repayment of these loans is to be made in fixed, predetermined installments.
- This type of loan is normally given to the borrowers for acquiring long-term assets, which will benefit the borrower over a long period (exceedingly at least one year). Purchases of plant and machinery, constructing building for factory, setting up new projects fall in this category.
- Financing for purchase of automobiles, consumer durables, real estate and creation of infrastructure also falls in this category.

1.2. Principles Of Good Lending/ Considerations for Grant of Loans: Lending is the most profitable business of a commercial bank, but it is highly risky too. Leading is always accompanied by the credit risk arising out of the borrowers' default in repaying the money. A banker should, therefore, manage his loan business in a safe and profitable manner. He should take all the necessary precautions to minimize the risk associated with the grant of a loan. In considering a loan proposal, he should bear in mind certain general principles of lending.

A. Safety
B. Liquidity
C. Diversification of Risks
D. Profitability
E. Purpose

These principles help him to set up some credit standards for evaluation of the loan applications of borrowers. Some of these principles are incompatible, e.g., liquidity and profitability, but a judicious banker is able to strike a satisfactory compromise between these two.

These principles are given below:

A. Safety: The safety of funds is the most important guiding principle of a banker. The safety of funds implies that the borrower would repay the principal sum and the interest thereon in the manner and on the conditions provided for in the loan agreement. While lending out funds, a banker should ensure that:

i) The loan to a particular borrower does not involve any avoidable risk of non-payment.

ii) A bank must follow an aggressive policy of lending in its bid to maximize earnings; but it has also to be defensive at the same time because it cannot afford to lose the people's (depositors) money.

iii) A banker should always take a calculated risk. Banker must always insist upon collaterals, margins and guarantees in addition to the personal promise of the borrower.

Thus, a bank should lend money after ensuring its full safety of repayment; otherwise, the banker will not be in a position to repay the deposits. Consequently, he will lose public confidence and thus subsequently may get ruined.

B. Liquidity: Liquidity means ease of conversion of an asset into cash. As a major part of commercial bank liabilities is payable either on demand or on short notice, the banker should ensure that the loans are liquid. Liquidity, thus, signifies the readiness with which the bank can convert its assets into cash with no or insignificant (small) loss.

i) A loan will be liquid if it has been given for a short period to finance some purchases of stock, raw materials, etc.

ii) A banker should give short-term advances which can be recalled in time to satisfy the demands of the depositors.

iii) Bank should not lend short period funds for a long time. As in that case, the loans and advances will tend to be less liquid, and it would be a great problem for it to realise cash in case of an emergency.

iv) Loans, to be liquid, should be given against the security of quickly realizable assets so that in case the borrower defaults in repayment; these might be readily converted into cash.

v) Cost of borrowing from the Reserve Bank of India:

- It is related to the net liquidity ratio.
- Net liquidity ratio is the ratio of the net liquid assets of the borrowing bank to its aggregate demand and time liabilities.

- The net liquidity ratio of a bank must be equal to the specified limit or above it, so that it may obtain a loan from the Reserve Bank at the bank rate.
- With every one percent drop in the net liquidity ratio of the borrowing bank, the cost of lending by the Reserve Bank goes up by one percent.

C. **Diversification of Risks:** A banker should adhere to the principle of diversification (spread) of risks while lending funds. Diversification implies the dispersal (lending) of funds over a large number of borrowers and borrowing firms situated in different parts of the country. In other words, a bank should not lend money to a few entities. Also, a bank should lend money in different types and ranges of interest whereby some are risky, some with less risk and some risk-free.

Purposes of this principle are:

- Minimizing the risk inherent in the grant of loans.
- It is a defensive policy to protect the bank against risk.
- Also, a device for increasing the average return on a fund that might otherwise, for the sake of safety, be confined to risk-free assets providing little or no return.
- A banker should remember that if he puts all his eggs in one basket he may lose all of them together at a time. In view of this, he should avoid concentrating the bank’s funds in a few customers. If these few customers do not pay then the bank may go bankrupt.
- A bank must offer advances to different firms belonging to different industries, which are situated over different geographical areas, so that he may not be badly affected by the failure of one industry or a few big borrowers.
- Maturity diversification: The most important form of diversification is maturity diversification. The loan portfolio should be such that different loans and advances have different maturity time. This results in continuous repayments throughout the year and thereby maintains liquidity of bank.

D. Profitability: Equally important is the principle of profitability. The difference between the lending and borrowing rates constitutes the gross profit of the bank. Banks need to earn profit for several reasons:

- Like other economic entities, banks must earn sufficient income to pay interest to the depositors in order to meet establishment charges, pay dividends to owners, and retain a portion of the income for the future growth, expansion and contingencies.
- Lending rates are affected by the bank rate, interbank competition and interbank agreements, where they have been agreed.
- No banker will and should ordinarily think of an advance without a satisfactory margin between the lending and borrowing rates.
- Different rates are charged, depending on the credit risk involved in the lending to different borrowers, type of loans, the nature of security, the mode of charge, the margin requirement.
- Advances should be given to customers after proper enquiry about the risk and credibility associated with him. Also, proper guarantees must be taken.

A prudent banker will avoid making profit at the expense of the liquidity and safety of his capital. Thus, within the limits of liquidity, safety, and the national policies as laid down by the government and the Central Bank, a banker should strive for accomplishing the objective of profitability.

E. Purpose: Bankers should always inquire about the purpose for which the loan is taken. As a matter of fact, the safety and liquidity of loan depends on the purpose for which it will be put.

- An advance given for productive purposes in all probability will be repaid because the grant of the loan will generate additional income for the borrower to enable him to repay it.
- An advance made for non-productive and speculative purposes is subject to greater credit risk because the purpose for which the loan was sought would in no way improve the repaying capacity of the borrower. Borrower may or may not be able to pay.

- There are chances that funds borrowed for a productive use may be used for speculative purposes. The banker (as far as possible) should, therefore, take follow-up steps to see that the end-use of credit is not for a purpose other than for which it is taken.

  Thus, a banker should avoid giving loans for wasteful expenditure, social functions and speculative transactions.

1.3. Types of Loans: Banks, these days, extend loans and advances to their customers in the following ways:

A. Term Loans (Outright Loans)
B. Cash Credits
C. Overdrafts
D. Bills Discounting

A. Term Loans (Outright Loans): A term loan is a loan from a bank for a specific amount that has a specified repayment schedule and either a fixed or floating interest rate. A term loan is often appropriate for an established small business with sound financial statements and the ability to make a substantial down payment to minimize payment amounts and the total cost of the loan.

(or)

"A term loan is a monetary loan that is repaid in regular payments over a set period of time. Term loans usually last between one and ten years, but may last as long as 30 years in some cases. A term loan usually involves an unfixed interest rate that will add additional balance to be repaid."

Banks provide outright loans for a fixed period. The borrower pays interest on the entire amount he has borrowed.

- Term loans are the opposite of fixed deposits in the bank. The repayment of these loans is to be made in fixed, predetermined installments.

- This type of loan is normally given to the borrowers for acquiring long-term assets, which will benefit the borrower over a long period (exceedingly at least one year). Purchases of plant and machinery, constructing building for factory, setting up new projects fall in this category.
- Financing for purchase of automobiles, consumer durables, real estate and creation of infrastructure also falls in this category.

Types of Term Loans: Term loans are granted by banks to borrowers for purchase of fixed assets like land and building, factory premises, embedded machinery etc., to enable their manufacturing activities, and their business expansion, if the amounts are repayable after a specific period of time, they are all called as term finance. On the basis of the period for which the funds are required by the borrowers, these loans are classified as short-, medium- and long-term loans. Banks have been given freedom to fix their own interest rate for loans and advances. As per bank's lending and interest rate policies applicable interest and other charges would be applicable to CC, OD, Term loan accounts. Each bank should decide "base rate" of interest on advances as per RBI directives.

Loans which are repayable within 1 – 3 years are classified as Short term, 3-5 years are classified as Medium Term and above 5 years are classified as long term.

Both intermediate-term loans and shorter long-term loans may also be balloon loans and come with balloon payments – so-called because the final installment swells or "balloons" into a much larger amount than any of the previous ones (no principal or a smaller amount of principal may have been paid along the way).

Term Loans - Important aspects:

- Term loans are given to the manufacturing, trading and service sector units which require funds for purchasing various items of fixed assets, such as, land and building, plant and machinery, electrical installation and other preliminary and pre-operative expenses.
- Repayment of term loans would depend upon the firm's capacity to produce goods or services by using the fixed assets as financed by banks.
- Like any other loan, a term loan is sanctioned by the bank, after evaluation of credit proposal (application). The bank before granting terms loans needs to carry out a clear due diligence as to the borrower's requirement, capacity and other aspects.
- While considering a term loan proposal, the bank need to verify the financial status, economic viability and the firm's production capacity.
- After proper verification and satisfaction of various requirements, banks can grant a term loan, on certain terms and conditions, covenants, including repayment terms.
- Term loans like any other credit facility needs to cover Six C concepts and the banks should follow bank's lending policy, exposure norms and the RBI's guidelines and directives
- All required valid collateral security, duly executed should be one of the pre conditions for the loan amount to be disbursed.
- The assets created out of the bank loan, are charged depending upon the nature of security (hypothecation, mortgage, etc.,
- At the time of fixing the limit and quantum of finance, a banker is required to make assessment of actual cost of assets to be acquired, margin to be contributed, sources of repayment, etc.

B. Cash Credits: In this case, the entire sanctioned (approved) amount of loan is not given to the borrower at one particular time. The bank opens an account of the borrower and allows him to withdraw the borrowed amount as and when he requires the money.

The bank charges interest, not on the amount of loan (CC) sanctioned, but on the actual amount withdrawn from the bank. Cash credit is very popular with Indian businessmen.

This account is the primary method of lending. Banks lend money against the security of commodities and debt. It runs like a current account except that the money that can be withdrawn from this account is not restricted to the amount deposited in the account.

C. Over Draft: The word overdraft means the act of drawing more than the money deposited in the bank account. In other words, the account holder overdraws.

When a customer gets an overdraft facility from a bank, he is allowed to draw cheques in excess of the balance standing to his credit to the extent of the amount of overdraft.

Example: If a bank has allowed overdraft to the extent of ` 50 lakh to a businessman, he can draw cheques in excess of the amount of his own deposits with the bank to the tune of ` 50 lakh.

The bank charges interest only on the amount overdrawn. For a businessman, the overdraft facility is the easiest and most convenient method of borrowing funds from banks.

Difference between the Cash Credit Account and Overdraft

The difference is very minor and relates to the operation of the accounts. In the case of cash credit, a proper limit is sanctioned, which normally is a certain percentage of the value of the stock/debts pledged by the account holder with the bank.

Whereas the overdraft is allowed against a set of other securities including financial instruments like shares, units of mutual funds, surrender value of LIC policy and debentures, etc.

D. Bills Discounting: Discounting or purchasing the bills of exchange is an important form of bank lending. Bill discounting is a major activity of some of the smaller banks. The bank takes the bill drawn by borrower on his (borrower's) customer and pays him immediately deducting some amount as discount/commission.

The bank then presents the bill to the borrower's customer on the due date of the bill and collects the total amount. If the bill is delayed, the borrower or his customer pays the bank a predetermined interest depending upon the predetermined terms.

Thus, by discounting bills, the bank pays money to the creditor when he needs it and allows the debtor to make payment only when the bill is due for payment. Discounting of bills of exchange is, therefore, really important form of bank lending.

1.3.1. Consortium Finance: Generally, banks finance their clients based on their lending policy. Sometimes a single banker may not be able to finance a customer. In such situations, more than one bank jointly grants loans and advances and other credit facilities to a borrower, such type of financing is called as consortium finance. Banks lend under consortium finance on account of: – Regulatory requirements – Restrictions on single and group borrower's limits – As part of risk management and diversification policy of banks – At the request of a borrower When two or more banks join together to finance a borrower it is called Consortium Financing. In case of consortium finance, based on a formal agreement between member banks of the consortium and the group would have identified a banker as 'Lead Bank'. The functions of lead bank as leader of the group, would include: (a) arranging meetings between the member banks (b) active involvement in credit appraisal, to obtain legal documents, to ensure proper charges are created on assets and also to monitor the account.

1.4. Non – Performing Assets (NPA's): Non-Performing Asset (NPA) is defined as a credit facility in respect of which the interest and/or installment of Bond finance principal has remained 'past due' for a specified period of time. NPA is used by financial institutions that refer to loans that are in jeopardy of default the so called NPL. Once the borrower has failed to make interest or principal payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in NPLs and often results in massive write-downs.

An example of NPA:

Suppose the State Bank of India (SBI) gives a loan of Rs. 10 crores to a company (E.g., Kingfisher Airlines). Consider that they agreed upon for an interest rate of say 10% per annum. Now suppose that initially everything was good and the market forces were working in support to the airline industry, therefore, Kingfisher was able to service the interest amount. Later, due to administrative, technical or corporate reasons suppose the company is not able to pay the interest rates for 90 days. In that case, a loan given to the Kingfisher Airlines is a good case for the consideration as NPA.

1.4.1. Reasons for Occurrence of NPA's: NPAs result from what are termed "Bad Loans" or NPL. Default, in the financial parlance, is the failure to meet financial obligations, say non-payment of a loan installment. These loans can occur due to the following reasons:

- Usual banking operations /Bad lending practices
- A banking crisis (as happened in USA, South Asia and Japan)
- Overhang component (due to environmental reasons, natural calamities, business cycle, Disease Occurrence, etc...)
- Incremental component (due to internal bank management, like credit policy, terms of credit, etc...)

1.4.2. Identification of NPA's: Accordingly, with effect from March 31, 2004, a non-performing asset (NPA)is a loan or an advance where;

- Interest and/or installment of principal remain overdue for a period of more than 91 days in respect of a term loan,

- The account remains ‘out of order’ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91days

1.4.3. Types of Non – Performing Assets: Further classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

1. **Sub-standard assets**: a sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. **Doubtful Assets**: An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.
3. **Loss assets**: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly.

Sub-standard asset is the asset in which bank have to maintain 15% of its reserves. All those assets which are considered as non-performing for period of more than 12 months are called as Doubtful Assets. All those assets which cannot be recovered are called as Loss Assets. Some advanced tools like Experian India's "Hunter Fraud Score" have also been launched that work on data mining and calculate some authentic score that can help banks detect fraud and lower their losses.

1.5. Retail Loans: A Retail loan is generally provided to an individual by a certified financial institution, a commercial bank or a credit union to purchase property, vehicles or other assets such as essential electronics, etc. One of the most common types of Retail loans is a Housing Loan.

This type of lending is meant for very small entrepreneurs as well as individuals who are engaged in some economic activity. Loans are given on the strength of the earnings of the borrower with an eye on the repaying capacity.

E.g.

- Gold loans
- Housing loans
- Personal loans
- Educational loans
- Vehicle loans
- Real Estate and Mortgage loans etc.,

1.5.1. Gold Loans: Gold loan is sanctioned by accepting the gold ornaments of the customer as pledge. Many nationalized banks, private banks and other financial companies offer this loan at attractive rates.

Advantages of Gold Loan:

- Gold loan doesn’t demand any certificate to show your salary or income and even no credit card history is required. Thus, even unemployed and non-working people can go for gold loan.
- Unlike any other unsecured loan, gold loan doesn’t require many papers, only few documents such as ID proof and address proof is enough to avail for such loan.
- One of the main advantages of gold loan is its low interest rates. Usually, loan over gold is provided at the interest of 12-16% per annum and this is quite low compared to personal loans available at interest rates of 15-26% per annum.

- Gold loan is the most simple and convenient forms of loan because here all you need to do is pledge your gold with a bank or finance company and get up to 80% of the market value of the gold as a loan.
- Borrower will be given an option to pay only interest during the entire term and at the end of the tenure you can pay complete borrowed amount in single shot.
- In case of gold loan processing time is very less. Usually, banks take just few hours to complete the process where as in case of NBFC's (Non-Banking Financial Companies) a few minutes is enough for the same. So, for immediate financial help this is the best option.

1.5.2. Housing Loans: A home loan is an amount of money that an individual borrows from a bank or money lending company at a certain rate of interest to be paid with the EMI every month. The property is taken as a security by the money lending company for the Home Loan.

Purpose:

a. Purchase of a ready built house / flat.
b. Construction of house / flat.
c. Purchase of site and construction of house thereon. However, loan for purchase of only site shall not be considered under Housing Loans. In case of composite Housing loans, utilisation of loan amount for purchase of plot is restricted to 60% of eligible / sanctioned loan amount.
d. For undertaking repairs, renovation, expansion, upgradation and creation of additional amenities with a monetary ceiling of Rs. 15.00 Lacs in case of repairs & renovations only.
e. For acquiring second house/flat where the borrower is already having a House/flat with or without loan.
f. For taking over of the HL liability from: -
   - All Public Sector Banks/Private Sector Banks
   - NBFCs/HFCs (rated externally as A & above)

   only in the case of Salaried class of borrowers with proper due diligence and after ensuring that the assessment by the NBFCs is acceptable and conforms to Bank's policy guidelines.

Eligibility:

a. Salaried individuals confirmed in the service with a minimum service of 3 years.
b. Individuals engaged in business / professionals and self-employed persons. Such applicants should have been in the business/profession for a minimum period of 3 years.
c. The entry age of the borrower/s shall be less than 60 years at the time of availing the loan and the ostensible liability in the normal course should get cleared before the borrower/s attain the age of 70 years.
d. Persons above the age of 60 years are also eligible subject to certain stipulations.

1.5.3. Personal Loans: A personal loan is a great credit instrument that helps one meet up money requirements for various purposes. Money required to meet requirements like wedding, medical expenses, home renovation, business requirements on cash among others. At times it is also taken to consolidate one's outstanding debt into one single loan. In India, there are several types of Personal Loans provided by Government Banks, Private Banks and NBFCs. Mostly Private Sector Banks and NBFCs provide high rate of Interest than Government Banks. Every Bank Provides Personal Loan on the basis of.

Advantages of Personal Loan:

- Flexibility of use - The money can be used for a variety of purposes as against most of the other loans where the funding is extended for a specific purpose. This gives personal loan an edge over other credit instrument.
- Easy availability - Personal loan applications get processed very fast. Generally, it does not rude harsh take more than a week-s time for the process to get completed and funds getting credited into account.
- Less documentation - Unlike other loans, personal loan requires minimal documentation. One only needs to submit the income documents and KYC (photo identity proof and address proof) for getting the request

processed. Ease of documentation is another factor that makes this loan highly popular to raise funds

- No requirement of collateral - Personal loan is extended taking into account the overall profile of the borrower and there is no requirement of collateral being extended by the borrower.

1.5.4. Educational loans: The educational loan or student loan is a good banking product for the young and growing Indian masses. Till some years back, higher education and quality education was not affordable to many brilliant students because of the financial problems. There was no alternative but to jump into the job market a shade too early. And this led to untimely end of budding talents and their forceful transformation into to mediocrity (less capable individuals).

Scholarships were there, but those were so less in numbers that only luckier few could avail of them. But now the scene has changed drastically. The boom in the banking sector has led to release of large amount of funds for education loans. Now, education loans are easily available from various banks in India and this change is encouraging more and more students to take up higher education despite their financial shortcomings.

Nationalized banks as well as private banks have come up with various educational loan schemes that students can benefit from. The current scenario is such that immediately after the results announcements of CAT or PMT/IIT-JEE, the representatives of the banks queue up for giving education loans to the successful candidate even with very flexible conditions. This scenario is certainly helping good students to pursue higher education and realize their dreams.

1.5.5. Vehicle Loans: The finance availed of to buy either a new or a used vehicle is known as vehicle loan. Vehicle loan is one of the complex loan products in India as vehicles dealers tend to include various discounts offered by vehicle manufacturers or lenders (banks and other financial institutions) in the interest rate offered to the buyer.

Types of vehicle loan: Here are three types of vehicle finance available today, viz.

1. For purchase of a new vehicle
2. For purchase of a used vehicle
3. Loan against an existing vehicle

1.5.6. Real Estate and Mortgage Loans: A mortgage is a loan in which property or real estate is used as collateral. The borrower enters into an agreement with the lender (usually a bank) wherein the borrower receives cash upfront then makes payments over a set time span until he pays back the lender in full.

Purpose: For any purpose except for financial speculation of any nature (Persons engaged in Property development/ property dealings/ brokers, share/stock brokers and persons engaged in any speculative activity Not Eligible Under The Scheme)

Key Benefits:

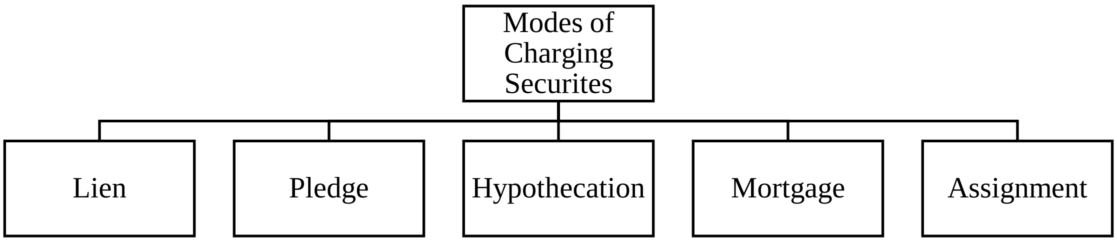
- Ideal use of idle property - Generate additional income from an otherwise idle property.
- Withdraw money as per your need and save on interest cost.
- Deposit surplus money / regular income / salary and save interest.
- Flexibility to withdraw money deposited earlier.
- Can be availed either as overdraft or demand loan as per your need.
- Competitive rate of Interest
- Loan available Up to Rs.10.00 Cr.

1.6. Modes of Bank Securities Against Loans:

Modes of Charging Security:

1. Lien
2. Pledge
3. Hypothecation
4. Mortgage

5. Assignment



1.6.1. Lien: Lien means the right to retain the goods of the borrower until the debts are repaid Lien gives a person only a right to retain the possession of the goods and not the power to sell unless such a right is expressly conferred by statute or by custom or by usage.

Kinds of Lien:

- **A particular lien:** this applies to one transaction or certain transactions only.
- **General lien:** this gives a right to a person to retain the goods not only in respect of a particular debt but also in respect of the general balance due form the owner of the goods to the person exercising the right of lien. It extends to all transactions.

1.6.2. Pledge: Pledge is the bailment of goods as security for payment of a debt. Only movable goods can be pledged. Section 172 of contract Act, 1872, defines a pledge as, the 'bailment of goods as security for payment of a debt or performance of a promise." Only movable goods can be pledged. From the above definition we observe that,

- A pledge occurs when goods are delivered for getting advance,
- The goods pledged will be returned to the owner on repayment of the debt,
- The goods serve as security for the debt.

The person who transfers the goods is called pledger and to whom it is transferred is called the pledgee.

1.6.3. Hypothecation: Hypothecation creates on equitable charge on movable property without possession. The mortgage of movable property for securing loan is called Hypothecation. In other words, in case of hypothecation, a charge over movable properties like goods, raw materials, goods in progress are created. Hypothecation is a charge against property for an amount of debt where neither ownership nor possession is passed to the creditor. Though the borrower is in actual physical possession, the constructive possession remains with the Bank as per the deed of hypothecation. The borrower holds the possession not in his own right as the owner of the goods but as the agent of the Bank. Being only an equitable charge on movable property without possession, hypothecation facility is risky as clean advances. So it is granted only to parties of undoubted means with the highest integrity. Moreover, bankers insist upon for giving some sort of collateral securities.

Features of Hypothecation:

- Charge against a property for an amount of debt,
- Goods remains in the possession of the borrower,
- Borrower binds himself to give possession of the hypothecated goods to the Bank when called upon to do so.
- It is a floating charge.
- It is rather precarious.

1.6.4. Mortgage: A mortgage is a conveyance of an interest in property (land or any immovable property) for securing a debt. A legal mortgage is created by a registered deed and gives the mortgagee the right of sale in case of default of the borrower. A mortgage is a method of creating charge on immovable properties like land and building.

Section 58 of the Transfer of Property Act 1882, define a mortgage as follows: "A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability."

Characteristics of a Mortgage: In terms of the definition, the following are the characteristics of a mortgage:

- A mortgage can be affected only on immovable property. Immovable property includes land, benefits that arise out of land and things attached to earth like trees, buildings and machinery. But a machine which is not permanently fixed to the earth and is shift able from one place to another is not considered to be immovable property.
- A mortgage is the transfer of an interest in the specific immovable property. This means the owner transfers some of his rights only to the mortgagee. For example, the right to redeem the property mortgaged.
- The object of transfer of interest in the property must be to secure a loan or performance of a contract which results in monetary obligation. Transfer of property for purposes other than the above will not amount to mortgage. For example, a property transferred to Liquidate prior debt will not constitute a mortgage.
- The property to be mortgaged must be a specific one, i.e., it can be identified by its size, location, boundaries etc.
- The actual possession of the mortgaged property is generally with the mortgager.
- The interest in the mortgaged property is re-conveyed to the mortgager on repayment of the loan with interest due on.
- In case, the mortgager fails to repay the loan, the mortgagee gets the right to recover the debt out of the sale proceeds of the mortgaged property.

1.6.5. Assignment: Assignment means transfer of any existing or future right, property or debt by one person to another person. The person who assigns the property is called assignor and the person to whom it is transferred is called assignee. Usually, assignment is made of actionable claims such as book debts, insurance claims etc.

In banking business, a borrower may assign to the banker

i) The book debts,
ii) Money due from government department
iii) Insurance policies

Type of Assignment: Assignment may be **two** types: -

1. **Legal Assignment**: A legal Assignment is an absolute transfer of actionable claim. It must be in writing signed by the assignor. The assignor informs his debtor in writing intimating the assignee's names and address. The assignee also gives a notice to the debtor and seeks a confirmation of the balance due.
2. **Equitable assignment**: An equitable assignment is one which does not fulfil all the above requirement.

Short Answer Questions (2 Marks)

1. What is Term Loan?
2. What is Consortium Finance?
3. What is NPA?
4. What is Gold Loan?
5. What is Housing Loan?
6. What is Education Loan?
7. What is Lien?
8. What is Pledge?
9. What is Hypothecation?

Essay Answer Questions (6 Marks)

1. What are the Considerations for Granting of Loans?
2. Write about various types of Loans?
3. Write briefly about NPA's?
4. Write briefly about Housing Loans?
5. What are the modes of bank securities against Loans? (or) What are the modes of charging securities?

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UNIT – IV

MICRO CREDIT – BANK LINKAGE PROGRAMME

Micro Credit - Bank Linkage Programme: SHG's – Formation – Self Help Groups finance – Bank Linkage - Revolving Fund – Financial inclusions: Mudra Loans – Features -Bank Mitra: Banking Correspondent – Business Facilitator – Duties and Responsibilities.

Learning Objectives

After studying this unit, the student will be able to

- Understand about Meaning of Micro Credit
- Understand about Self Help Groups
- Understand about Micro Credit – Bank Linkage Programme
- Understand about Financial Inclusion.

1. **Introduction**: Microcredit is a common form of microfinance that involves an extremely small loan given to an individual to help them become self-employed or grow a small business. These borrowers tend to be low-income individuals, especially from less developed countries (LDCs). Microcredit is also known as "Microlending" or "Microloan."

   The concept of microcredit was built on the idea that skilled people in underdeveloped countries, who live outside of traditional banking and monetary systems could gain entry into an economy through the assistance of a small loan. Modern microcredit is typically attributed to the Grameen Bank model, developed by economist Muhammad Yunus. This system started in Bangladesh in 1976, with a group of women borrowing $27 to finance the group's own small businesses. The women repaid the loan and were able to sustain the business.

   All commercial banks in India have been directed by Government of India and Reserve Bank of India to actively participate in the Government Sponsored Credit-linked schemes and targets are also allotted to different banks on the basis of the number of branches operating in the area and the scope of lending. Besides, various State Government sponsored schemes, the Central Government has launched the following major two schemes:

- **National Rural Livelihood Mission (NRLM)**
- **Women Self Help Groups (SHGs) and their Federations**

1.1. National Rural Livelihood Mission (NRLM): The Ministry of Rural Development, Government of India has launched National Rural Livelihood Mission (NRLM) by replacing the existing Swarna Jayanti Gram Swarozgar Yojana (SGSY), effective from April 1, 2013. NRLM is the flagship program of Govt. of India for promoting poverty reduction through building strong institutions of the poor, particularly women, and enabling these institutions to access a range of financial services and livelihoods services.

1.2. Women Self Help Groups (SHGs) and their Federations: Women SHGs under NRLM consist of 10-15 persons. In case of special SHGs i.e., groups in the difficult areas, groups with disabled persons, and groups formed in remote tribal areas, this number may be a minimum of 5 persons. NRLM will promote affinity-based women Self –help groups. Only for groups to be formed with Persons with disabilities, and other special categories like elders, transgender, NRLM will have both men and women in the self-help groups. SHG is an informal group and registration under any Societies Act, State cooperative Act or a partnership firm is not mandatory. However, Federations of SHGs formed at village level, cluster level, and at higher levels are to be registered under appropriate acts prevailing in their States.

1.2.1. Financial Assistance to the SHGs: NRLM would provide a Revolving Fund (RF) support to SHGs in existence for a minimum period of 3/6 months and follow the norms of good SHGs, i.e., they follow ‘Panchasutra’ – regular meetings, regular savings, regular internal lending, regular recoveries and maintenance of proper books of accounts. Only such SHGs that have not received any RF earlier will be provided with RF, as corpus, with a minimum of` 10,000 and up to a maximum of ` 15,000 per SHG. The purpose of RF is to strengthen their institutional and financial management capacity and build a good credit history within the group.

1.2.2. Revolving Fund: A revolving fund is a fund or account that remains available to finance an organization's continuing operations without any fiscal year limitation, because the organization replenishes the fund by repaying money used from the account. Revolving funds have been used to support both government and non-profit operations.

1.2.3. Self Help Groups (SHG's): A SHG is a community-based group with 10-25 members. Members are usually women from similar social and economic backgrounds, all voluntarily coming together to save small sums of money, on a regular basis. They pool their resources to become financially stable, taking loans from their collective savings in times of emergency or financial scarcity, important life events or to purchase assets. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment. In India, RBI regulations mandate that bank offer financial services, including collateral free loans to these groups, on very low interest rates. This allows poor women to circumvent the challenges of exclusion from institutional financial services. This system is closely related to that of solidarity lending, widely used by microfinance institutions.

Beyond their function as savings and credit groups, SHGs offer poor women a platform for building solidarity. They allow women to come together and act on issues related to their own lives including health, nutrition, governance and gender justice.

1.2.4. Self Help Groups – Bank Linkage Programme: A major effort to provide banking services to the weaker and unorganised sector was the Bank Self Help Group Linkage Programme that was launched in early 1990s. The programme was started at the initiative of NABARD in 1992 to link the unorganised sector with the formal banking sector.

Working of the Programme: Under this programme, banks were allowed to open savings accounts for Self-Help Groups (SHGs). SHGs are registered/unregistered entities which usually has a membership of 15 to 20 members from very low-income families, usually women. They mobilize savings from members and uses the pooled funds to give loans to the needy members. Under this programme, banks provide loans to the SHGs against group guarantee and the quantum of loan could be several times the deposits placed by such SHGs with the banks. Banks should consider entire credit requirements of SHG members, namely,

(a) income generation activities,

(b) social needs like housing, education, marriage, etc. and

(c) debt swapping".

Lending to SHGs should be included by the banks as part of their lending to the weaker sections. As per the RBI's latest (May 2016) Priority Sector Lending norms, bank credit to members of SHGs is eligible for priority sector advance under respective categories viz., Agriculture, Micro, Small and Medium Enterprises, Social Infrastructure and Others.

The recovery rates of loans are good and banks have found that the transaction cost of reaching the poor through SHGs is considerably lower rather than direct lending by the bank.

Savings and Lending under SHG linkage: According to NABARD as on 31 March 2014, there were around 74.30 lakh savings-linked SHGs, covering over 9.7 crore poor households. The total savings of these SHGs with banks amounted to Rs 9897 crore. The number of credit-linked SHGs under the programme was around 42 lakhs.

The initial phase of SHG movement saw concentration of SHGs in the southern parts of the country, but now the SHGs have spread more to the eastern and north-eastern regions where the extent of financial exclusion is greater. The Government of India has also been using the SHGs for subsidy-linked credit schemes for the poor. NABARD offers grant assistance to NGOs that promote SHGs and link them to banks.

1.2.5. Advantages of Financing through SHGs:

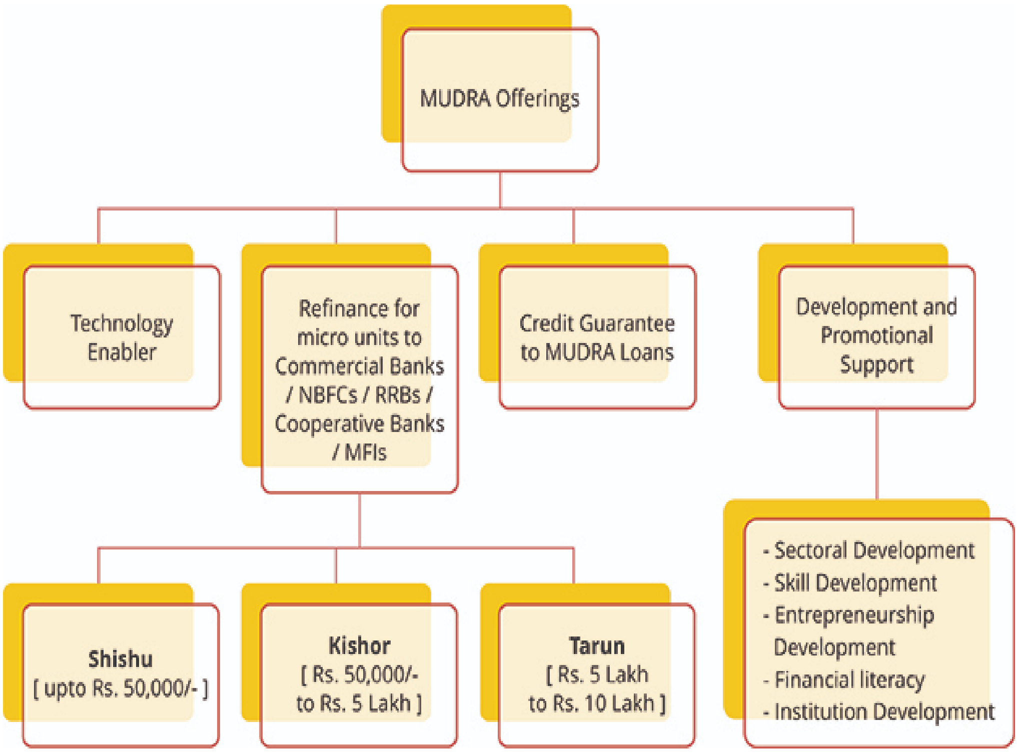
- An economically poor individual gains strength as part of a group.
- Besides, financing through SHGs transaction costs for both lenders and borrowers.
- While lenders have to handle only a triple SHG account instead of a large number of small-sized individual accounts, borrowers as part of an SHG minimize or travel (to and from the branch and other places) for completing paper work and on the loss of workdays in canvassing for loans.
- Where successful, SHGs have significantly empowered poor people, especially women, in rural areas.
- SHGs have helped immensely in reducing the influence of informal lenders in rural areas.
- Many big corporate houses are also promoting SHGs at many places in India.
- SHGs help borrowers overcome the problem of lack of collateral. Women can discuss their problem and find solutions for it.

1.3. Financial Inclusion: Financial Inclusion is described as the method of offering banking and financial solutions and services to every individual in the society without any form of discrimination. Financial inclusion stands for delivery of appropriate financial services at an affordable cost, on timely basis to vulnerable groups such as low-income groups and weaker section who lack access to even the most basic banking services.

According to Dr. C. Rangarajan (Chairman the Committee on Financial Inclusion – 2008) Financial Inclusion is “The process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost”.

1.3.1. PMJDY: The PMJDY is a National Mission for Financial Inclusion to ensure that every individual in the country has access the financial services. These would include access to Banking/ Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner. The scheme was launched earlier this year by Indian Prime Minister Narendra Modi. A lot of accounts have been opened thus far under the scheme.

1.3.2. MUDRA Loans: Micro Units Development and Refinance Agency Ltd. [MUDRA] is an NBFC supporting development of micro enterprise sector in the country. MUDRA provides refinance support to Banks / MFIs for lending to micro units having loan requirement up to Rs.10 lakh. MUDRA provides refinance to micro business under the Scheme of Pradhan Mantri MUDRA Yojana. The other products are for development support to the sector. The bouquet of offerings of MUDRA is depicted below. The offerings are being targeted across the spectrum of beneficiary segments.



Pradhan Mantri MUDRA Yojana (PMMY)

Under the aegis of Pradhan Mantri Mudra Yojana (PMMY), MUDRA has created products / schemes. The interventions have been named 'Shishu', 'Kishor' and 'Tarun' to signify the stage of growth / development and funding needs of the beneficiary micro unit / entrepreneur and also provide a reference point for the next phase of graduation / growth to look forward to:

- Shishu: covering loans up to ₹ 50,000/-
- Kishor: covering loans above ₹ 50,000/- and up to ₹ 5 lakh
- Tarun: covering loans above ₹ 5 lakh and up to ₹ 10 lakh

It would be ensured that more focus is given to Shishu Category Units and then Kishor and Tarun Categories.

Within the framework and overall objective of development and growth of micro enterprises sector under Shishu, Kishor and Tarun, the products being offered by MUDRA are so designed, to meet requirements of different sectors / business activities as well as business / entrepreneur segments.

The funding support from MUDRA are of four types:

- Micro Credit Scheme (MCS) for loans up to ₹ 1 lakh finance through MFIs.
- Refinance Scheme for Commercial Banks / Regional Rural Banks (RRBs) / Scheduled Co-operative Banks
- Women Enterprise programme
- Securitization of loan portfolio

Micro Credit Scheme:

Micro Credit Scheme is offered mainly through Micro Finance Institutions (MFIs), which deliver the credit up to ₹ 1 lakh, for various micro enterprise activities. Although, the mode of delivery may be through groups like SHGs/JLGs, the loans are given to the individuals for specific income generating micro enterprise activity. The MFIs for availing financial support need to enroll with MUDRA by complying to some of the requirements as notified by MUDRA, from time to time.

Refinance Scheme for Banks:

Different banks like Commercial Banks, Regional Rural Banks and Scheduled Cooperative Banks are eligible to avail of refinance support from MUDRA for financing micro enterprise activities. The refinance is available for term loan and working capital loans, up to an amount of ₹10 lakh per unit. The eligible banks, who have enrolled with MUDRA by complying to the requirements as notified, can avail of refinance from MUDRA for the loan issued under Shishu, Kishor and Tarun categories.

Women Enterprise Programme:

In order to encourage women entrepreneurs, the financing banks / MFIs may consider extending additional facilities, including interest reduction on their loan. At present, MUDRA extends a reduction of 25bps in its interest rates to MFIs / NBFCs, who are providing loans to women entrepreneurs.

Securitization of Loan Portfolio:

MUDRA also supports Banks / NBFCs / MFIs for raising funds for financing micro enterprises by participating in securitization of their loan assets against micro enterprise portfolio, by providing second loss default guarantee, for credit enhancement and also participating in investment of Pass-Through Certificate (PTCs) either as Senior or Junior investor.

Purpose of Mudra Loan:

Mudra loan is extended for a variety of purposes which provide income generation and employment creation. The loans are extended mainly for:

- Business loan for Vendors, Traders, Shopkeepers and other Service Sector activities
- Working capital loan through MUDRA Cards
- Equipment Finance for Micro Units
- Transport Vehicle loans

Features of Mudra Loan:

- The bank offers refinance support to banks so that these can provide funds to micro units. The quantum of MUDRA loans is below Rs.10 lakh. The funding support constitutes micro credit schemes for small loans, refinance schemes for regional rural banks/ commercial banks/scheduled co-operative banks, programmes for women's enterprises, and securitisation of loan assets.
- Credit Guarantee is offered to borrowers under the MUDRA loan scheme. Under Credit Guarantee, risk sharing is offered for a set of homogenous loans, instead of a loan guarantee for an individual debt. This improves the efficiency and receptiveness of the Credit Guarantee product.
- Promotional and development support is provided to customers. This includes skill development, sectoral development, improvement of financial literacy, entrepreneurship development, and institution development.

1.4. **Bank Mitra**: A Bank Mitra acts like an agent in facilitating bank and banking related services, especially in unbanked areas of the country. They help in areas where there is no ATMs and branches of banks. A Bank Mitra provides numerous services to the unbanked people of India. They first take a look at potential customers and help them in opening accounts by verifying identity and collecting all relevant documents.

1.4.1. Business Correspondents (BC's): Business Correspondents are retail agents who represent banks and are responsible for delivering banking services at locations other than a bank branch/ATM. **BCs** support banks in providing its limited range of banking services at affordable cost. Thus, they are pivotal in promoting financial inclusion. Business Correspondents are permitted to carry out transactions on behalf of the bank as agents. According to the RBI's mandate, the products offered by BCs include Small Savings Accounts, Fixed Deposit and Recurring Deposit with low minimum deposits, Remittance to any BC customer, Micro Credit and General Insurance. The BC model helps banks in bringing door-step delivery of services especially 'cash in - cash out' transactions in areas which are to nearer to the rural population, thus resolving the issue of last-mile delivery.

1.4.2. The Role and Responsibilities of the BCs:

a) Enrolment of customers, including collection of biometric and other details, provide card (ID Card, Debit Card, Credit Card), PIN.

b) Provide transaction facility.

   i) Deposit of money in an account with any bank

   ii) Withdrawal of money from an account with any bank

   iii) Remittances from an account with a bank to an account with the same or any other bank.

   iv) Balance Enquiry and issue Receipts/ Statement of Accounts.

c) Disbursal of credit facilities to borrowers involving small amounts strictly as per the instructions of the Bank.

d) Other activities:

   - Identification of borrowers and classification of activities as per their requirements.

- Collection and prima facie scrutiny of loan applications including verification of primary data.
- Creating awareness about savings and other products offered by the Bank and education and advice on managing money & debt counselling.
- Preliminary scrutiny of data and submission of applications to the Bank for its review.
- Promotion, nurturing, monitoring and handholding of Self-Help Groups and/or Joint Liability Groups and/or Credit Groups and others.
- Facilitating the repayment of dues owed to the bank by its customers.
- Marketing of third-party financial products.

1.4.3. Products Offering by Business Correspondents: The following products are to be offered by the CSPs to their clients.

- No Frills Savings Bank accounts
- Recurring Deposit Accounts
- Remittances
- Fixed Deposit
- Overdraft/Retail loans
- KCC/GCC (Kisan Credit Card/ General Credit Card)
- Third party financial products.

1.4.4. Business Facilitators (BF's): Business Facilitators (BFs) are representatives appointed by banks to act as their agent and provide banking services in remote locations where the bank does not have a presence in order to promote financial inclusion. The Business Facilitator's can refer clients, pursue the clients' proposal and facilitate the bank to carry out its transactions, but cannot transact on behalf of the bank.

1.4.5. Functions / Activities of Business Facilitators:

i) Identification of borrowers and fitment of activities

ii) Collection and preliminary processing of loan applications including verification of primary information/data
iii) Creating awareness about savings and other products and education and advice on managing money and debt counselling
iv) Processing and submission of applications to banks
v) Promotion and nurturing Self Help Groups/Joint Liability Groups
vi) Post-sanction monitoring
vii) Monitoring and handholding of Self-Help Groups/Joint Liability Groups/Credit Groups/others
viii) Follow-up for recovery

<u>Short Answer Questions (2 Marks)</u>

1. What is SHG?
2. What is NRLM?
3. What is Revolving Fund?
4. What is Financial Inclusion?
5. What is MUDRA Loan?
6. What is PMJDY?
7. Who is Bank Mitra?
8. Who is Business Correspondent?
9. Who is Business Facilitator?

<u>Essay Answer Questions (6 Marks)</u>

1. Write briefly about Self Help Group – Bank Linkage Programme?
2. Write briefly about Mudra Loan?
3. What is the role and responsibilities of Business Correspondent?
4. What are the functions of Business Facilitator?

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UNIT – V
CLEARING HOUSE

Clearing House: Meaning –Clearing Structure – Clearing Process – Settlements of Funds – Return Clearing – Inter Branch Clearing – Time Lag – Collection of Outstation Instruments – CTS cheques clearance.

Learning Objectives

After studying this unit, the student will be able to

- Understand about Clearing House meaning, Structure
- Understand about Clearing Process

1. Introduction: In India, the clearing system is local and confined to a defined jurisdiction covering all the banks and branches situated in the area under a particular zone. The clearing house is a voluntary association of banks under the management of a bank where the settlement accounts are maintained. Wherever Reserve Bank of India has its office (and a banking department), the clearing house is managed by it. In the absence of an office of the Reserve Bank, the clearing house is managed by the State Bank of India, its associate banks and in a few cases by public sector banks.

In India there are about 1050 cheques clearing houses. These clearing houses clear and settle transactions relating to various types of paper-based instruments like cheques, drafts, payment orders, interest / dividend warrants, etc. In 40 of these clearing houses, cheque processing centres (CPCs) using MICR (Magnetic Ink Character Recognition) technology have been set up. At 14 more clearing houses, MICR cheque processing systems are proposed to be set up. The Reserve Bank has issued the Uniform Regulations and Rules for Bankers' Clearing Houses (URRBCH) which have been adopted by all the clearing houses. These regulations and rules relate to the criteria for membership / sub-membership, withdrawal / removal / suspension from membership and the procedures for conducting of clearing as well as settlement of claims between members.

1.1. Objectives of The Clearing House:

(a) To make arrangements for the speedy and economic collection of Magnetic Ink Character Recognition (MICR) instruments and other instruments;

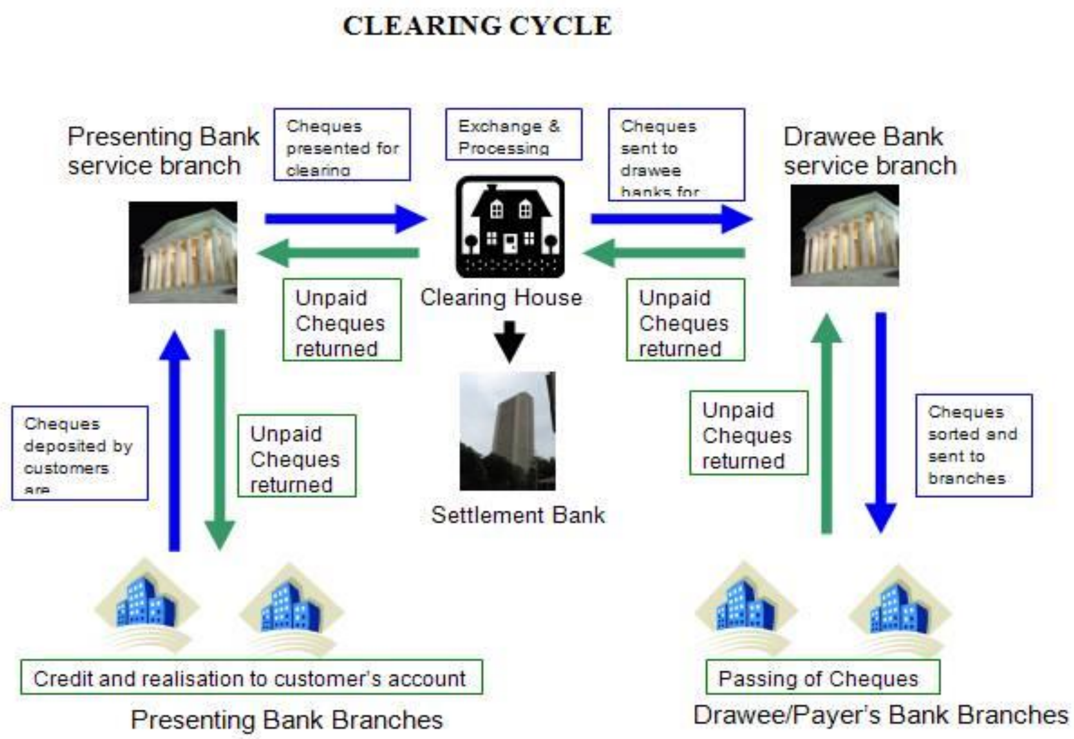
(b) To make arrangements, and to frame rules relating to the collection or non-collection or documents between Members and Sub-members of the Clearing House.

(c) To maintain records of the Clearing House and of such other matters as may be thought fit.

(d) To draw up and prescribe from time-to-time forms for use of the Members and Sub-members of the Clearing House in connection with the clearing.

(e) To do all such other lawful things as are incidental or conducive to the attainment of all or any of the foregoing objects.

1.2. Clearing Cycle:



Cheques Clearing Cycle: Following steps are to be taken during clearance of cheque:

- The presenting bank where cheques are presented by payee for deposit in his / her a/c.
- Regional collecting centre- to collect all cheques from their presenting branch.
- To collect cheques from RCC and for settlement of cheques.
- Again, they collect cheques from the clearing house and send to their drawee bank.
- It collects cheques from their RCC and debits the customer a/c.
- **Settlement of Funds**: The settlement of funds in clearing occurs at several levels. The aggregate amount or value of cheques presented by a bank on other banks represents the claim by that bank on other banks. All the banks on every other bank in the clearing make similar claims. A net settlement is arrived at the clearinghouse and the debit or credit position of the bank is determined. These are booked in their current accounts maintained by the settling bank. This represents the inter-bank settlement. The settlement of funds between the service branch and the branch concerned represents the transfer of funds to the branch level.

  The payment process is completed only when the funds are debited from the drawer's account and credited to the payee's account. This occurs after the completion of the return clearing mentioned.
- **Inter-Branch Clearing:** Cheques presented by customers drawn on different branches of the same bank need not be sent to the clearing house as the transfer of funds is internal to the bank. The service branch usually acts as a settlement branch for the branches and the instruments are sent to the drawee branches while the inter-branch accounts are credited or debited internally. (Fate of returned cheques)
- **Collection of Outstation Instruments (Cheques):** Cheques drawn on other banks at outstation centres will normally be collected through the Bank's branches at those centres. Where the Bank does not have a

branch of its own, the instrument would be directly sent for collection to the drawee bank or collected through correspondent bank.

- **Speed Clearing:** Bank is participating in a "Speed Clearing" introduced by Reserve Bank of India. The "Speed Clearing" is currently available in all MICR centres across the country. Under "Speed Clearing" system, cheques payable at any Core Banking Solution (CBS) branches of any banks of any centres are collected through local clearing and not through outstation collection.
- **Cheques drawn on foreign countries:** Cheques drawn on foreign countries are accepted for collection on the best of efforts basis. Bank may enter into specific collection arrangement with its correspondent bank for speedy collection of such instrument. Bank would give credit to the party on credit of proceeds to the bank's Nostro Account with the correspondent bank after taking into account cooling periods as applicable to the countries concerned.
- **Cheques / Instruments lost in transit / in clearing process or at paying bank's branch:** In the event a cheque or an instrument accepted for collection is lost in transit or in the clearing process or at the paying bank's branch, the bank shall immediately on coming to know of the loss, bring the same to the notice of the account holder so that the account holder can inform the drawer to record stop payment. The bank would provide all assistance to the customer to obtain a duplicate instrument from the drawer of the cheque.

1.3. Time Lag/Span (Time Frame for Collection of Local / Outstation Cheques /Instruments): The total clearing cycle including the return clearing introduces a time span in the payments process. The need for physical presentment of the cheque at the branch where it is drawn on, requires the movement of cheques from one place to another.

As a result, the recipient of payment has to wait until the collecting banker is fully satisfied that the cheque has been paid. This time lag will continue irrespective of the level of technology and improvements in process, so long as the physical presentment of the cheque is necessary as per the banking law.

i) **Local Cheques:** Local cheques are payable within the jurisdiction of the clearing house and will be presented through clearing system prevailing at the centre. Credit arising out of local cheques shall be given to the customer's accounts immediately after closure of the relative return clearing and withdrawal shall be allowed on the same day or maximum within an hour of commencement of business on the next working day, subject to usual safeguards.

ii) **Outstation Cheques:** Time frame for collection of cheques and other instruments sent for collection and drawn on State Capital shall be 7 days, in case of Major Cities –10 days and at all other locations 14 days.
The above-mentioned timeframe shall be treated as outer limit and credit shall be afforded, if the process gets completed earlier.

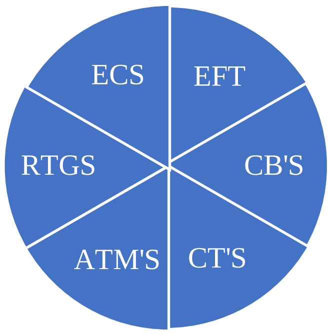
iii) **Policy of compensation on delayed collection:** The bank will pay interest to its all types of customers on delayed collection as applicable on saving bank deposit for the delayed period beyond the prescribed period i.e., 7/10/14 days as the case may be. Such interest shall be paid without demand from the customers in all types of accounts.

1.4. Automated Clearing Systems:

- **Clearing House Inter-Bank Payment System (CHIPS):** This is a clearing system run by New York clearing house. The financial transactions such as – foreign and domestic trade services, international loans, syndicated loans, foreign exchange trade settlements, are carried out through CHIPS. The CHIPS have a direct interface with the SWIFT system.
- **Clearing House Automated Payment System (CHAPS):** CHAPS is an automated system set up in UK which ensures immediate settlement of payments.
- **Clearing House Automated Transfer System (CHATS):** CHATS provide the inter-bank transfer facilities in Hong Kong. CHATS provide same day inter-bank settlement, instant order confirmation and enquiry

facilities. The integrity of message transmission is carried out through authentication and encryption techniques.

1.4.1. Electronic Fund Management:



IT revolution has paved way for banks to implement different systems to handle funds management in banks. This methodology is collectively recognized as Electronic Fund Management.

Electronic Fund Transfer System (EFT):

There are various types of electronic clearing systems functioning in the retail payments area in the country. Some of them are ECS, NEFT etc.

- **Electronic Clearing Service (ECS)** is a retail payment system that can be used to make bulk payments / receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments rather than for funds transfers by individuals. The ECS facility is available in 47 centres across India operated by RBI at places where it manages the clearing houses and by SBI and its associates in other centers. The ECS is further divided into two types – ECS (Credit) to make bulk payments to individuals/vendors and ECS (Debit) to receive bulk utility payments from individuals
- **National Electronic Funds Transfer (NEFT) system** is a nationwide funds transfer system to facilitate transfer of funds from any bank branch to any other bank branch. This is typically for individual / single payments. The system uses the concept of centralized accounting system

and the bank's account that is sending or receiving the funds transfer instructions, gets operated at one centre, viz. Mumbai only. The individual branches participating in NEFT could be located anywhere across the country. The beneficiary gets the credit on the same Day or the next Day depending on the time of settlement. NEFT operates on a deferred net settlement (DNS) basis which settles transactions in batches. Presently it is settled in six batches the last one being 1600 hrs. on a weekday and 3 batches with the last one being 1200hrs on a Saturday. To participate in NEFT the participating banks branch needs to have IFSC code.

Indian Financial System Code (IFSC) is an alpha numeric code designed to uniquely identify the bank-branches in India. This is 11-digit code with first 4 characters representing the banks code, the next character reserved as control character (Presently 0 appears in the fifth position) and remaining 6 characters to identify the branch. The MICR code has 9 digits to identify the bank-branch.

1.4.2. Large Value Payments: There are a few large value payment systems functioning in the country. These are the Inter-Bank Cheques Clearing Systems (the Inter-bank Clearing), the High Value Cheques Clearing System (the High Value Clearing), the Government Securities Clearing System (the G-Sec Clearing), the Foreign Exchange Clearing System (the Forex Clearing) and the Real Time Gross Settlement (RTGS) System. All these systems except the High Value Clearings are electronic based systems. These mostly relate to interbank / inter-financial institutional transactions except the High Value Clearing where high value customer cheques are cleared.

The Inter-bank Clearing functions in 7 places and the High Value Clearing in 15 places – both are managed by the Reserve Bank. The G-Sec Clearing and the Forex Clearing are managed by the Clearing Corporation of India Limited (CCIL). The RTGS System is operated by the Reserve Bank. All these are deemed to be Systemically Important Payment Systems (SIPS) and therefore the Reserve Bank has, in line with the international best practices in this regard, moved them (except High Value Clearings) to either secure and guaranteed systems or the RTGS System.

- **Real Time Gross Settlement (RTGS)** is a large value funds transfer system whereby financial intermediaries can settle interbank transfers for their own account as well as for their customers on a “real time” and on “gross” basis. The system effects final settlement of interbank funds transfers on a continuous, transaction- by-transaction basis throughout the processing day (RTGS business hours). The RTGS system is primarily for large value transactions. The minimum amount to be remitted through RTGS is Rs.1 lakh. There is no upper ceiling for RTGS transactions. On a typical day, RTGS handles about 14000 transactions a day for an approximate value of Rs.1,50,000 crore.
- **Core Banking Solutions (CBS):** Core Banking Solutions has helped banks to offer better customer service. It has also reduced the time and increased the efficiency. The Core Banking Solutions mainly work on the support of effective communication and good information technology. It is on account of merger of communication technology and information technology which enables the banks to offer core banking needs of the clients.
- **Computerization of Clearing of Cheques:** Over the years Reserve Bank of India as a facilitator has been playing a vital role in the implementation of innovative systems, to enable banks not only to function effectively but also to offer better customer service. RBI is in charge of the clearing house and clearing operations. It has always taken lead to introduce new systems to speed up clearing process as well to reduce the turnaround time in clearance of funds. Computerization of clearing operations was the first major step initiated by RBI, over the years RBI has been upgrading the system with new changes. To overcome the increasing volume of cheques through the clearing mechanism, RBI has fully automated the clearing house operations. This is based on the Magnetic Ink Character Recognition technology; RBI upgraded the clearing functions with new set of MICR cheques. Under this new system, cheques should have MICR

code consisting of 9 digits. Each cheque would have the unique 9-digit MICR code along with the cheque number.

MICR code consists of 9 digits as:

– First three digits indicates CITY {identical to the first three digit of the postal pin code of the CITY (For example: in case of Mumbai, it would be 400)}

– Next three digits represents the Bank and each bank has been given a three-digit code called bank code

– Last three digits denote the branch code

Under this MICR system the computer program would read and sort out the cheques based on the codes, thereby, in quick turnaround time, the system is able to handle volume.

1.4.3. Cheque Truncation System (CTS): Cheques are being used as a medium for exchange of funds, which play a key role in the funds management of customers and banks. The efficient cheque clearing system helps in settlement of receipts and payments. Cheque Truncation is a new system introduced in Indian Banking Scenario. It is a system of cheque clearance and settlement between banks based on electronic data and/or images without the need for exchange of physical cheques and negotiable instruments like demand drafts, pay orders, dividend warrants, etc.

Cheque Truncation - Special Features:

– Bank customers would get their cheques realized faster

– Quick realization helps in better cash management (receivables/payables)

– In the long run, it would reduce the administrative costs for bank

– Importantly this would assist banks in reconciliation and also reduction in clearing frauds.

The remitting customer has to furnish the following information to a bank for effecting a RTGS/NEFT remittance:

1. Amount to be remitted
2. His account number which is to be debited
3. Name of the beneficiary bank
4. Name of the beneficiary customer
5. Account number of the beneficiary customer

6. Sender to receiver information, if any
7. The IFSC code of the receiving branch

While RTGS remittance would be credited to a beneficiary's account by maximum time lag of two hours, NEFT transaction depending on the timing of the transfer will be transferred the same day or the next day and in both the cases when the transfer has not happened the money would be returned to payer's account

- **Systemically Important Payment Systems (SIPS)** – The Committee on Payment and Settlement Systems (CPSS) of Bank for International Settlements (BIS) serves as a forum for central banks to monitor and analyze developments in domestic payment, clearing and settlement systems as well as in cross-border and multicurrency settlement schemes. This committee published core principles of Systemically Important Payment Systems (SIPS). They emphasize the importance of "systemically important" payment systems. If such systems are insufficiently protected against risk, disruption within them could trigger or transmit further disruptions amongst participants or systemic disruptions in the financial area more widely. Systemic importance is determined mainly by the size or nature of the individual payments or their aggregate value. Systems handling specifically large-value payments – mostly interbank transactions – would normally be considered systemically important.
- **Indian Financial System Code (IFSC):** IFSC is an alpha-numeric code that identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11-digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), which is reserved for future use and the last six digits are numeric characters represents the branch. Correct IFSC code is essential for identifying the beneficiary's branch and bank as destination for funds transfers. E.g., Syndicate Bank Cuffe Parade Branch, Mumbai-SYNB0005087.

Short Answer Questions (2 Marks)

1. What is Clearing House?
2. Expand EFT, RTGS, ECS.
3. What is EFT?
4. What is RTGS?
5. What is ECS?
6. What is IFSC Code?

Essay Type Questions (6 Marks)

1. What are the Objectives of Clearing House?
2. Write about Clearing House Process?
3. Write briefly about Electronic Fund Transfer System?
4. What are the features of CTS?

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UNIT – VI

E – BANKING SERVICES

E-Banking Services: Debit Card – Credit Card – Features – Mobile Banking - Online Banking -— RuPay Cards - Core Banking – advantages -Teller System: Cash Deposit Machines - Cheque Deposit Machines - Intra-bank Transfer – Inter-bank Transfers - EFT – RTGS - ECS – IMPS - DDs - Digital Wallets (Paytm, Phone pay etc.,). – Digital Banker – Features – UPI Payments.

Learning Objectives

After studying this unit, the student will be able to

- Understand about E – Banking Services
- Understand about Teller System
- Understand about Digital Wallets, UPI Payments.

1. **Introduction:** Electronic banking has many names like e banking, virtual banking, online banking, or internet banking. It is simply the use of electronic and telecommunications network for delivering various banking products and services. Through e-banking, a customer can access his account and conduct many transactions using his computer or mobile phone.

1.1. Levels of E – Banking Services:

Level 1 – This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.

Level 2 – In this level, banks allow their customers to submit instructions or applications for different services, check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.

Level 3 – In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

Most traditional banks offer e-banking services as an additional method of providing service. Further, many new banks deliver banking services primarily through the internet or other electronic delivery channels. Also, some banks are ‘internet only’ banks without any physical branch anywhere in the country.

1.2. Benefits of E – Banking:

Banks:

- Lesser transaction costs – electronic transactions are the cheapest modes of transaction
- A reduced margin for human error – since the information is relayed electronically, there is no room for human error
- Lesser paperwork – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.
- Reduced fixed costs – A lesser need for branches which translates into a lower fixed cost.
- More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

Customers:

- Convenience – a customer can access his account and transact from anywhere 24x7x365.
- Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.
- No geographical barriers – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

Businesses:

- Account reviews – Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.

- Better productivity – Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.
- Lower costs – Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.
- Lesser errors – Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.
- Reduced fraud – Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

1.3. **E-Banking in India**:

In India, since 1997, when the ICICI Bank first offered internet banking services, today, most new-generation banks offer the same to their customers. In fact, all major banks provide e-banking services to their customers.

After demonetisation in 2016, digital banking has grown at a faster pace. Most of the Indian banks have launched their internet banking and mobile banking websites to facilitate the customers with online availability of almost all banking products. Internet banking is now a common mode of secure and convenient banking services.

Popular Services Under E-Banking In India:

- ATMs (Automated Teller Machines)
- Telephone Banking
- Electronic Clearing Cards
- Smart Cards
- EFT (Electronic Funds Transfer) System

- ECS (Electronic Clearing Services)
- Mobile Banking
- Internet Banking
- Telebanking
- Door-step Banking

1.3.1. Internet Banking: It is the type of electronic banking service which enables customers to perform several financial and non-financial transactions via the internet. With internet or online banking or net-banking, customers can transfer funds to another bank account, check account balance, view bank statements, pay utility bills, and much more.

Features of Internet Banking: Here are some of the best features of internet banking:

- Provides access to financial as well as non-financial banking services
- Facility to check bank balance any time
- Make bill payments and fund transfer to other accounts
- Keep a check on mortgages, loans, savings a/c linked to the bank account
- Safe and secure mode of banking
- Protected with unique ID and password
- Customers can apply for the issuance of a chequebook
- Buy general insurance
- Set-up or cancel automatic recurring payments and standing orders
- Keep a check on investments linked to the bank account

1.3.2. Mobile Banking: This electronic banking system enables customers to perform financial and non-financial transactions via mobile phone. Most of the banks have launched their mobile banking applications available on Google Playstore and Apple App Store. Just like the net-banking portal, customers can use the mobile application to access banking services.

1.3.3. SMS Banking: SMS banking is a form of mobile banking. It is a facility used by some banks or other financial institutions to send messages (also called notifications or alerts) to customers' mobile phones using SMS messaging, or a service provided by them which enables customers to perform some financial transactions using SMS.

1.3.4. ATM: Automated Teller Machines (ATM) is one of the most popular types of e-banking. ATMs allow customers to withdraw funds, deposit money, change Debit Card PIN, and other banking services. To make use of an ATM, the user must have a password. Banks charge a nominal fee from the customers on every transaction made after crossing the specified limit of free transactions if the transaction is done from any other bank's ATM.

Features: The features of the automated teller machine include the following.

- Transfer funds between linked bank accounts
- Receive account balance
- Prints recent transactions list
- Change your pin
- Deposit your cash
- Bill payments
- Cash withdrawal

1.3.5. Cash Deposit Machine (CDM): The Cash Deposit Machine (CDM) is a self-service terminal that lets you make deposits and payment transactions by cash. All successful transactions are immediately credited and customers will be issued an advice slip confirming the transaction.

1.3.6. Cheque Deposit Machine: Cheque Deposit Machines accept the cheques and also provides additional facility of account name /number verification for credit to the correct account. CDMs have gained popularity as cheques can be deposited even after bank working hours.

1.3.7. Debit Card: Almost every person owns a debit card. This card is connected to your bank account and you can go cashless with this card. You can use your debit card for all types of transactions, the transaction amount is debited from your account instantly.

Features:

- It is Pay Now Product.
- A card issued by a bank allowing the holder to transfer money electronically to another bank account when making a purchase.

- You can withdraw money from ATM directly using this card.
- It is a plastic payment card that can be used instead of cash when making purchases.
- Debit card purchases can usually be made with or without a personal identification number (PIN).
- Debit cards usually have daily purchase limits as well, meaning you can't spend more than a certain amount with them in one 24-hour period.

1.3.8. Credit Card: A credit card is a payment card issued to users (cardholders) by bank to enable the cardholder to pay a merchant for goods and services based on the cardholder's promise to the card issuer to pay them for the amounts plus the other agreed charges. The bank may also grant a line of credit (LOC) to the cardholder which allows the holder to borrow money in the form of a cash advance. The issuer pre-sets borrowing limits which have a basis on the individual's credit rating. It is a Pay Later Product.

Features:

- It is Pay Later Product.
- A standard credit card has no extra perks or benefits but may offer a low-interest rate to attract customers.
- The credit limit on a credit card reflects the amount of credit extended to the credit card holder by the lender.
- Interest rate determines how much in finance charges you'll pay on the card's balance.
- Transfer money at lower interest rates.
- Avail Encash up to or above your credit limit.
- Make instant, easy and safe payments with just a tap of your card or smartphone.

1.3.9. RUPAY Card: RuPay Card is an Indian domestic card conceived and launched by National Payments Corporation of India (NPCI) in 2012. It was introduced in the Indian payment system to reduce the monopoly of foreign gateways like Visa and MasterCard because these are foreign companies or American companies and their commission is high i.e. the cost of transaction is high.

Therefore, we can say that RuPay Card is an Indian payment gateway. It also works like Visa or Master Card and its commission is low. RuPay facilitates electronic payment at all Indian banks and financial institutions.

1.3.10. Point-of-Sale Transfer Terminals: This service allows customers to pay for the purchase through a debit/credit card instantly.

1.3.11. Digital Banking: Digital banking is the digitization of all traditional banking activities and programs that historically were only available to customers when physically inside of a bank branch.

Features:

- Online banking
- Personal Finance Planning
- Mobile Banking
- UPI Services
- Digital Wallets
- Rewards and Loyalty Programmes
- Non – Internet Based Phone Banking (SMS Services)

1.3.12. Digital Wallets: A digital wallet refers to an electronic device or online service that allows an individual to make electronic transactions. An individual's bank account can also be linked to the digital wallet. They might also have their driver's license, health card, loyalty card(s) and other ID documents stored on the phone. Paytm, Phone pe, airtel money etc., are examples of digital wallets.

1.3.13. UPI: UPI or Unified Payments Interface is an immediate real-time payment system that helps in instantly transferring the funds between the two bank accounts through a mobile platform. Hence, UPI is a concept that allows multiple bank accounts to get into a single mobile application. This idea was developed by the National Payments Corporation of India and is controlled by the RBI and IBA (Indian Bank Association).

1.3.14. IMPS: Immediate Payment Service (IMPS) is an instant payment inter-bank electronic funds transfer system in India. IMPS offers an inter-bank electronic fund transfer service through mobile phones. Unlike NEFT and RTGS, the service is available 24/7 throughout the year including bank holidays.

1.3.15. Types of Fund Transfers using Internet Banking: As we have already discussed in previous unit, there are three types of fund transfers which can be made using net-banking. Let us understand more-

A. Inter - Bank Transfer: Inter Bank Transfer enables electronic transfer of funds from the account of the remitter in one Bank to the account of the beneficiary maintained with any other Bank branch. There are two systems of Inter Bank Transfer – RTGS and NEFT. Both these systems are maintained by Reserve Bank of India.

i) **RTGS** (Real Time Gross Settlement): This is a system where the processing of funds transfer instructions takes place at the time they are received (real time). Also, the settlement of funds transfer instructions occurs individually on an instruction-by-instruction basis (gross settlement). RTGS is the fastest possible interbank money transfer facility available through secure banking channels in India.

- This payment system ensures that the receiver’s account gets credited with the funds almost immediately and not after a certain duration, as is the case with other payment modes like NEFT
- RTGS transactions are tracked by the RBI, thereby successful transfers are irreversible. This method is majorly used for large value transfers
- The minimum amount to be remitted through RTGS is 2 lakhs. There is no cap on the maximum amount for transfer via RTGS Like NEFT, RTGS is also available online 24×7.

ii) **NEFT** (National Electronic Fund Transfer): This system of fund transfer operates on a Deferred Net Settlement basis. Fund transfer transactions are settled in batches as opposed to the continuous, individual settlement in RTGS. Presently, NEFT operates in half hourly batches. There will be 48 half-hourly batches every day. The settlement of first batch will commence after 00:30 hours and the last batch will end at 00:00 hours.

The system will be available on all days of the year, on a 24 x 7 basis, including holidays.

- Using NEFT, individuals and corporates can transfer funds electronically from any bank branch to any individual or corporate with an account with any other bank branch in the country
- NEFT service is available 24×7 on internet banking. But it is a time-restricted service at the bank branch
- Usually, NEFT transfer is successfully completed within 30 minutes. Nonetheless, the time can even stretch to 2-3 hours or might be completed in just 10 minutes.

B. **Intra Bank Transfer**: Intra bank transfer means transferring of amount to beneficiary having account in same bank. E.g.-A who has an account in SBI transfer 500rs to B who also has account in SBI.

1.4. Core Banking: Core (Centralized Online Real-time Exchange) banking is a banking service provided by a group of networked bank branches where customers may access their bank account and perform basic transactions from any of the member branch offices. Core banking is often associated with retail banking and many banks treat the retail customers as their core banking customers. Businesses are usually managed via the corporate banking division of the institution. Core banking covers basic depositing and lending of money. Core banking functions will include transaction accounts, loans, mortgages and payments. Banks make these services available across multiple channels like automated teller machines, Internet banking, mobile banking and branches. Banking software and network technology allow a bank to centralise its record keeping and allow access from any location.

Advantages:

i) Limited Professional Manpower to be utilized more effectively.

ii) Customer can have anywhere, more convenient and easier banking.

iii) ATM, Internet Banking, Mobile Banking, Payment Gateways etc. are available.
iv) More strong and economical way of management information system.
v) Reduction in branch manpower.
vi) Additional manpower can be available for marketing, recovery and personalized banking.
vii) Instant information available for decision support.
viii) Quick and accurate implementation of policies.
ix) Improved Recovery Process causing reduction on recovery costs, NPA provisions.
x) Innovative, redefined or improved processes i.e. Inter Branch Reconciliation causing reduction in manpower at Head Office.
xi) Reduction in software maintenance at branch and Head office.
xii) Centralized printing and backup resulting in reduction in capital and revenue expenditure on printing and backup devices and media at branches.
xiii) Electronic Transactions with other Financial Institutions.
xiv) Increased speed in working resulting in more business opportunities and reduction in penalties and legal expenses.

Short Answer Questions (2 Marks)

1. What is E – Banking?
2. What is Debit Card?
3. What is Credit Card?
4. What is Digital Wallets?
5. What is RuPay Card?
6. What is UPI?
7.What is IMPS?
8.What is Intra – Bank Transfer/

Essay Type Questions (6 Marks)

1. What are the benefits of E – Banking Services?
2. What are the features of Debit Card?
3. What are the features of Credit Card?
4. Write about Inter Bank Transfer System?
5. What are the advantages of Core Banking?

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UNIT – VII

INSURANCE AGENT / AGENCY SERVICES

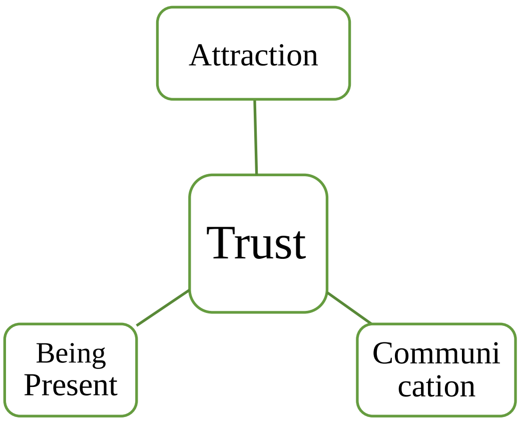
Insurance Agent / Agency Services: Need – Methods for Insurance Agents to improve Customer Service – Insurance Agencies Services (BPO) – Insurance Agent Recruitment Process.

Learning Objectives

After studying this unit, the student will be able to

- Understand about Insurance Agent / Agency Services
- Understand about Insurance Agent Recruitment Process

1. Introduction: Insurance agents sell and negotiate life, health, property, or other types of insurance to match the needs of their clients. As an insurance agent, you may work for an insurance company, refer clients to independent brokers, or work as an independent broker. Marketing also plays a large part in the day-to-day duties of an insurance agent. Successful insurance agents implement marketing strategies to promote new and current insurance policies. Marketing activities are also crucial to bringing new customers to your agency.



1.1. Types of Insurance Agents: The three types of insurance agents are captive agents, independent agents, and insurance brokers. While captive insurance agents are dedicated to selling insurance products from one company, independent agents can represent as few as one insurance company or up to several dozen insurers. You may choose to work with an insurance broker when you need specialty coverage. Learn more about these types of insurance agents below.

i) **Individual Agents**: An individual agent is one who has undergone requisite training, passed an examination and been duly licensed by IRDA to sell insurance policies to the public and provide after-sales service including assisting at the time of a claim. His licence may be for life insurance, general insurance or both. In addition to representing one life insurance company and one non-life insurance company an agent can also represent one standalone health insurance company as well as Agriculture Insurance Company of India for selling crop insurance and Export Credit Guarantee Corporation of India for credit insurance.

ii) **Captive or Exclusive Insurance Agent**: This type of agent represents a single insurance company or a specified group of insurance companies, meaning they can only offer you one quote, or price, for an insurance policy.

These agents are easily identified, as the sign in front of their building is typically the name of a large insurer. These large insurance companies are typically advertised nationally on television.

Captive agents are generally not employees of the insurance company they represent.

These agents are paid a commission (or percentage) of the total price of your policy by the insurance company they place you with.

iii) **Insurance Brokers**: Brokers represent the customer rather than the insurance companies.

The difference between a broker and an independent agent is minimal.

As with independent agencies, these companies can be named after an individual person or by any number of other names.

1.2. Need:

- Selling different kinds of insurance policies that are offered by the company.
- Assuming you make the right decision and go with an independent insurance agent, you have a much better chance at saving money.

Independent insurance brokers use their experience as leverage to keep insurance companies honest with their rates. They also shop your policies annually.

- When you buy insurance directly from an insurance company, you are limited to their products only. Independent insurance brokers however, can provide you with products from almost any insurance carrier on the marketplace based on your price and coverage preferences.
- Independent insurance brokers also offer the freedom of a one stop shop. By consolidating your insurance needs under one roof, you will avoid multiple rounds of phone calls, policy agreements and rotating account managers. you will also save yourself a lot of time.
- Think of your agent like an advisor, a lawyer and an advocate. They handle all of the complex, unsatisfying aspects of insurance on your behalf, while providing insight and advice when necessary.

1.3. Insurance Agent / Agency Role in Providing Services: Agent / Agency role begins at the stage of sale and continues through the duration of the contract, and includes the following steps.

i) The Point of Sale - Best Advice: The first point for service is the point of sale. One of the critical issues involved in purchase of non-life Insurance is to determine the amount of coverage [Sum Insured] to be bought. Here it is important to keep a basic percept in mind - Do not recommend insuring where the risk can be managed otherwise.

ii) The Proposal Stage: The agent has to support the customer in filling out the proposal for insurance. The insured is required to take responsibility for the statements made therein. It is very important that the agent should explain and clarify to proposer the details to be filled as answer to each of questions in the proposal form. In the event of a claim, a failure to give proper and complete information can jeopardise the customer's claim.

iii) Acceptance Stage: In this stage, an agent gets to make contact with the customer. If company rules permit a policy document being delivered in person, it may be a good idea to collect it and present the document to the customer.

iv) **Policy Renewal:** Non-life insurance policies have to be renewed each year and the customer has a choice at the time of each renewal, to continue insuring with the same company or switch to another company. This is a critical point where the goodwill and trust created by the agent and the company gets tested. The agent needs to be in touch with the customer well before the renewal due date to remind the latter about renewal so that he can make provision for the same.

v) **The Claim Stage:** The agent has a crucial role to play at the time of claim settlement. It is her task to ensure that the incident giving rise to the claim is immediately informed to the insurer and that the customer carefully follows all the formalities and assists in all the investigations that may need to be done to assess the loss.

1.4. Duties and Responsibilities of an Insurance Agent:

- Selling different kinds of insurance policies that are offered by the company.
- Making sure that new clients meet all the requirements set by the company.
- Making sure there is consistent communication with new clients.
- Coming up with new plans and customizing existing plans for different clients.

Additional Responsibilities of an Insurance Agent:

- Attend meetings, seminars, and programs to learn about new products and services
- Calculate premiums and establish payment methods
- Report the progress of initiatives to stakeholders
- Maintain bookkeeping systems, databases, and records
- Monitor insurance claims
- Meet customers' expectation to ensure satisfaction of insurance coverage
- Continuously educate yourself on the industry and learn about new products and services
- Fulfil all policy requirements
- Help clients settle any claims on their insurance
- Customize insurance programs to suit individual customer needs

- Ensure that policy requirements are fulfilled, including completion of the appropriate forms
- Inspect property in order to examine its overall condition and decide its insurance risk
- Make sure all paperwork is filled out and filed to put insurance policies in place
- Assist customers in properly completing insurance applications in order to act as an intermediary between the customer and the insurance company

1.5. Methods for Insurance Agents to Improve Customer Service:

i) **Simplify the Experience:** Create a website that could better understand and serve customers. When customers are not able to easily find what they are looking for on a website, they are likely to seek help elsewhere. Simplify things to provide a customer-first efficient experience. Your service should allow for personalized experiences to drive business and satisfy customers. How you care and empathizes with customers can make all the difference. Consider your target audience and use technology to make their lives and their families' lives easier.

ii) **Connect with Your Clients:** No one likes filling out repetitive insurance forms. Make it easy and even enjoyable to get insurance coverage by designing a communication platform for customers. You may consider implementing a chat on your site that asks conversational questions. Understanding what is important to customers and what their plans are for the future, can build lasting relationships.

iii) **Be Available:** It is becoming increasingly important to customers to get their questions asked from the comfort of their own home. Insurers should be available and accommodating to that.

iv) **Provide the Right Tools:** Customers want to keep their insurance premiums as low as possible while still having the protection they need. Create programs that track customers' patterns and use that information to develop incentives for lower premiums. Show your dedication by giving your customers the tools for self-efficiency.

v) **Allow Customization:** Not every customer need insurance all the time. Offer policies that allow customers to only pay for insurance as they need it. It's a popular solution for many individuals. If a service can always be easily updated, that show that specialization and finding unique solutions for certain groups of customers is a priority.

1.6. Insurance Agent Recruitment Process: Recruitment Process Under the regulation of Insurance Agents Regulatory Act 2000, any person desirous of obtaining an agent's license shall have to pass the pre-recruitment examination in life or general insurance business conducted by an examination body duly recognised by the Insurance Regulatory and Development Authority (IRDA).

Become An Agent: The insurance agent is the interface and an ambassador between a company and the individual. An insurance agent's ultimate mission is to provide consistent quality and satisfaction to customers and a profitable return to the company

The insurance industry today is undergoing dramatic changes due to the development of new innovations that are strengthening existing customer relationships as well as seeking new relationships. With the liberalisation of the Indian insurance sector that threw open doors to many insurance companies to set up their bases in India, the imminent challenge is the management of a huge number of insurance agents and policyholders.

Stringent processes such as interviews, selection criteria, recruitment of insurance agents, training and certification processes are posing new challenges, especially considering the complexity of Indian topography and population density.

Recruitment Process:

Qualification of the Applicant: The applicant must possess the minimum qualification of pre-university or equivalent examination conducted by any recognised board or institute, where the applicant resides in a place with a population of 5,000 or more as per the last census, and pass in tenth standard or equivalent examination from any recognised board or institution if the applicant resides in any other place.

An applicant applying for a license to act as an insurance agent will have to complete training from an IRDA-approved institution with at least 50 hours of practical training in life or general insurance business, as the case may be, which may be spread over three to five weeks. For renewal of his license, the agent will have to undergo training for just 25 hours.

Composite Agent's Training: Applicants seeking license to act as a composite agent shall have to undergo training in an approved institution, with at least 50 hours' practical training in life and general insurance business, which may be spread over 2 to 3 weeks.

To Become an Insurance Agent in India: you must pass the IRDAI IC 38 pre-recruitment qualification exam. The exam is conducted by institutes sanctioned by IRDAI. 2. If you want to become an insurance agent, you are expected to register online via IRDAI's portal.

1.7. Business Process Outsourcing (BPO): Business Process Outsourcing, Also Known as BPO, Is When a Company Hires a Third-Party Provider to Handle a Variety of Its Day-To-Day Operations. BPO Started in The Manufacturing Industry, But in Recent Years, It Has Spread to Many Other Industries, Especially Insurance. The Insurance Industry Continues to Grow. Consequently, Insurers Are Continuously Looking for Growth Opportunities and Ways to Improve Operational Efficiency. BPO Services for Insurance Companies Have Evolved from Being Considered a Risky Business Strategy to A Widely Accepted Option. It Has Been Adopted by A Growing Number of Insurance Providers Ranging from Auto and Home to Health Insurance.

Types of BPO Services:

i) Accounting
ii) IT Services
iii) Print-Mail Services
iv) Customer Service
v) Payroll and Payment Processing

vi) Product Research and Quality Assurance

Insurance Agencies Services (BPO):

BPO services are an alternative print solution for the insurance industry. BPO printing utilizes outsourced business resources to handle document processing, printing, mail production and delivery of all of your policyholder communications. This includes data processing, printing, mailing, electronic document management, and job tracking. Companies that choose to outsource their printing and mailing gain the peace of mind that the production and delivery of their policy notices are always compliant with regulations. Process outsourcing can also offer improvements in overall efficiencies of day-to-day business activities and reduced operational costs.

The insurance industry has shown steady growth for the first time in years. Estimates put it at a three to four percent increase projected by the end of 2019. Many insurance companies are looking to capitalize on this upward financial trend. The goal of BPO outsourcing is to make sure that business operations run as efficiently and effectively as possible. With the many benefits of the optimized processes, postage discounts, and others, this has led to an increase in BPO for the insurance industry.

BPO Services Offer to Insurance Agencies:

Our insurance BPO strategies not only help you improve process efficiency, but also help your insurance producers refocus on what they do best - generating income for your independent insurance agency. We offer various portfolio management services for insurance brokers across several insurance verticals; including Property and Casualty (P&C) insurance, Life insurance, Health insurance and Annuity insurance.

As an independent insurance agency, you can benefit from the following services offered:

- Teams of insurance professionals are adept at working with multiple carriers to get insurance quotes and then prepare a summary according to the client proposal requirements. As an added advantage, we also extract Carrier Financial Ratings for every quote summary.

- Insurance claims administration services include claim investigations, interpretation and application of appropriate governing compliance standards and fraud prevention policy provisions.
- Insurance back-office experts ensure that the process involved in receiving and issuing a certificate of insurance is fast and accurate. This process is further strengthened by efficient third-party communication and processing of revised certificates after policy renewals.
- Document indexing and filing services allow fast access of properly segregated documents, as and when required. Documents are labeled and indexed as per the naming conventions requested by the client, so that it can be easily searched and edited.
- Professional insurance staff save your valuable time by sending loss run requests to previous insurance carriers, and providing loss run data timely during policy renewals. Before preparing the claims report, our team analyses the loss run data, and sends it to the underwriters, and notifies them, in case the loss run data is missing.
- BPO team ensures that the policy checking process for an insurance agency is fast and accurate. All policy documents are reviewed for completeness and correctness and any variance present is recorded. These variances are then reported to the insurance carriers and a request for revised policy document is made. This process ensures that a final policy document without any variance is received and issued.
- Insurance billing experts ensure accurate and timely delivery of invoices to the respective carriers and constant follow-up for timely collection of payments. They also confirm that the premium installments on a policy are set up as per customer requests. Once a payment is received, it's duly recorded and indexed in our database, where the archives are maintained as per the clients' needs.
- BPO Team help you effectively plan and manage policy renewals by keeping track of renewals in advance and sending renewal reminders when

necessary. They also help in receiving renewal requests and interacting with the carriers for renewals, thereby ensuring that any adjustments to an insurance policy is taken into account before the renewal process commences.

- Other BPO services include insurance policy management services, new business services, insurance commissions management, insurance reporting, insurance claims data entry, insurance claims management, insurance accounting services, and insurance legal services, among others.
- Scrutinization of accounting and insurance records can be a painstaking task in insurance and accounting. The oversight in validation and documentation can lead to unpleasant outcome devouring time and effort to remedy.

Short Answer Questions (2 Marks)

1. Who is Individual Agent?
2. Who is Capative or Exclusive Insurance Agent?
3. Who are Insurance Brokers?

Essay Type Questions (6 Marks)

1. What is the need of Insurance Agents?
2. What are the duties and responsibilities of Insurance Agents?
3. What are the methods followed by Insurance Agents to Improve Customer Services?
4. What services offered by Independent Service Agency?

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UNIT – VIII

REGULATION OF LIFE INSURANCE AND NON – LIFE INSURANCE

Regulation of Life Insurance and Non-Life Insurance: Practical aspects of Life Insurance, procedure for issuing a life insurance policy, issue of duplicate policies, nomination, surrender value, policy loans, assignment, revivals and claim settlement. (Formats of types of Insurance). Regulation of Insurance in India- Insurance Act, 1938 and IRDA 1999. Insurance Regulatory Development Authority – Functions of I.R.D.A.

Learning Objectives

After studying this unit, the student will be able to

- Understand about procedure for issuing a life insurance policy
- Understand about surrender value
- Understand about IRDA

1. **Introduction:** Insurance regulatory law is the body of statutory law, administrative regulations and jurisprudence that governs and regulates the insurance industry and those engaged in the business of insurance. Insurance regulatory law is primarily enforced through regulations, rules and directives by state insurance departments as authorized and directed by statutory law enacted by the state legislatures. Insurance is characterized as a business vested or affected with the public interest. Thus, the business of insurance, although primarily a matter of private contract, is nevertheless of such concern to the public as a whole that it is subject to governmental regulation to protect the public's interests.

1.1. Procedure for Taking a Life Policy:

i) **Filling Up a Proposal Form:** Life policy is based on the principal utmost good faith. The procedure-filling in the form is quite simple. It is almost like a home industry where the person who wishes to make an investment in the form of insurance. The first thing to do is to fill in a proposal form.

ii) **Medical Examination:** If the applicant has a family history of disease, then the investment procedure is more detailed and description about permanent immunity and other family diseases have to be given including habits, name, income, occupation and salary. A person of normal health almost goes through a medical examination as a matter of formality.

iii) **Medical Report:** The next step after filling-in proposal form is to undergo a medical examination from one of the doctors approved by the Life Insurance Corporation. The examination is usually of a routine kind where the identification of the applicant, his appearance, measurement, weight, condition of teeth, eyes, throat, tongue, ears, condition of heart, chest, digestion, nerve system and past operation is taken into consideration to find out the life span of the individual.

iv) **Agent's Report:** The third step consists of a report which is confidential in nature. It is made by the agent who is underwriting the life of the person. His report consists of the age of the person insuring himself, his health, occupation, soundness of payment of premium, proper health and longevity of life.

v) **Acceptance of Proposal:** The Life Insurance Corporation accepts the proposal of the insurer on the commitment made by the agent and after taking into consideration the doctor's medical report. The factors which play a dominating role is the mode of premium, type of policy, the age of the applicant, his health, occupation and habits. Once these factors have been considered and the Life Insurance Corporation's officers are satisfied, the form is accepted. An investor's form will be rejected only if he suffers from serious diseases or the longevity of life cannot be guaranteed.

vi) **Proof of Age:** The next step after accepting the proposal of a person is to ask him to submit the proof the age.

vii) **Mode of Premium:** When an investor takes a life policy on his portfolio, he must pay some installment to the life insurance company for this investment. This installment is called premium and may be paid periodically. It may be paid annually, half-yearly, quarterly or monthly. Usually, a period of 30 days is given as grace beyond the due date of payment of premium. The rates of premium are different for different kinds of policies offered as investment.

viii) Issue of Policy: When all these formalities are completed the Life Insurance Corporation sends a life policy to the insured. This legal document between the life company and the insured states the details of the policy.

It gives details regarding the age, address, sum assured, type of policy with or without profits, date of maturity, premium, mode of payment of premium, name of person who is entitled to receive the ultimate sum, amount at the termination of the policy, the surrender value of the policy, the settlement of claims of policy and all other conditions of the contract.

The Life Insurance Corporation sends this policy under its seal and signature of its officers. On receiving this policy, the investor begins his investment with the Life Insurance Corporation of India.

1.2. Issue of Duplicate Policy: A duplicate policy confers on its owner the same rights and privileges as the original policy. The following are the requirements for issuing a duplicate policy:

i) Insertion of an advertisement at the policyholder’s cost in one English daily newspaper having wide circulation in the State where the loss is reported to have occurred. A copy of the Newspaper in which the advertisement appeared should be sent to the servicing office one month after its appearance. If no objection has been lodged with LIC regarding the policy in question, a duplicate policy will be issued after complying further requirements, i.e., Indemnity Bond and payment of charges for preparing duplicate policy and stamp fee.

ii) However, the requirement of advertisement and Indemnity Bond may be dispensed with or modified in certain circumstances as given below:

- loss of policy by theft
- destruction of policy by fire
- loss of policy while in custody of an office of government
- mutilated or damaged policy
- policy in torn and a part of it is missing
- policy partially destroyed by white ants

1.3. Nomination: The nominee is statutorily recognized as a payee who can give a valid discharge to the Corporation for the payment of policy monies.

Nomination will be incorporated in the text of the policy at the time of its issue. After the policy is prepared and issued and if no Nomination has been incorporated the assured can ordinarily affect the nomination only by an endorsement on the policy itself. A nomination made in this manner is required to be notified to the Corporation and registered by it in its records. A nomination is not required to be stamped.

Any change or cancellation of nomination should be given in writing only by the Life Assured.

Nomination under Joint Life Policy can only be a joint nomination. Nomination in favour of a stranger cannot be made as there is no insurable interest and moral hazard may be involved. Nomination in favour of wife and children as a class is not valid. Specific names of the existing wife and children should be mentioned. Where nomination is made in favour of successive nominees, i.e., nominee “A” failing him to nominee “B” failing whom nominee “C”, the nomination in favour of one individual in the order mentioned will be considered. Where the nominee is a minor, an appointee has to be appointed to receive the monies in the event of the assured’s death during the minority of the nominee. No nomination can be made under a policy financed from HUF funds.

In the case of first endorsement of nomination the date of registration of nomination will be the date of receipt of the policy by the servicing office and in case of any other nomination or cancellation or change thereof, the date of receipt of the policy and/or of notice whichever is later, will be the date of registration.

1.4. Assignment: An assignment has an effect of directly transferring the rights of the transferor in respect of the property transferred. Immediately on execution of an assignment of the Policy of life assurance the assignor forgoes all his rights, title and interest in the Policy to the assignee. The premium/loan interest notices etc. in such cases will be sent to the assignee. In case the assignment is made in favor of public bodies, institutions, trust etc., premium notices/receipts will be addressed to the official who has been designated by the institutions as a person to receive such notice.

An assignment of a life insurance policy once validly executed, cannot be cancelled or rendered in effectual by the assignor. Scoring of such assignments or super scribing words like 'cancelled' on such assignment does not annul the assignment. And the only way to cancel such assignment would be to get it re-assigned by the assignee in favour of the assignor.

There are two types of assignments:

i) Conditional Assignment: whereby the assignor and the assignee may agree that on the happening of a specified event which does not depend on the will of the assignor, the assignment will be suspended or revoked wholly or in part.

ii) Absolute Assignment: whereby all the rights, title and interest which the assignor has in the policy passes on to the assignee without reversion to the assignor or his estate in any event.

1.5. Surrender Value: Surrender Value If a policyholder decides to terminate the policy before maturity, the amount which the insurance company will pay to the policyholder is known as surrender value. If the policyholder does a mid-term surrender, he would get a sum of what has been allocated towards savings and earnings on them.

A surrender change would be deducted from this amount and this varies from policy to policy. If the policy holder terminates the cover after five years, then as per the recent IRDAI Directive, life insurance companies can’t levy any surrender charges. The policy holder will then get the fund value of his investment only.

Types of the Surrender Value: There are two types of surrender value called

i) Guaranteed surrender value and

ii) Special surrender value

i) Guaranteed Surrender Value: The amount of money guaranteed to be payable by the insurance company on surrendering the insurance policy before completion of maturity. Guaranteed surrender value is determined based on the surrender value factor specified in the policy document. The surrender value factor is the percentage of total premiums paid. Surrender value factor increases with the number of years of the policy. Surrender value factor will get close to 100% of premiums paid when the policy nears maturity. Hence, the guaranteed surrender value is calculated as total premiums paid multiplied by the surrender value factor.

ii) Special Surrender Value: Special surrender value is usually higher than the guaranteed surrender value. However, it depends on the insurance company. Special surrender value depends on the sum assured, premiums paid, policy term and bonuses. Generally, special surrender value is calculated,

Special Surrender Value = (Paid-Up Value + Accrued Bonuses) X Surrender Value Factor

Where Paid-Up Value = Basic Sum Assured X (Number of Premiums Paid/Number of Premiums Payable)

1.6. Policy Loan: A policy loan is issued by an insurance company and uses the cash value of a person's life insurance policy as collateral. Sometimes it is referred to as a "life insurance loan." Traditionally, policy loans were issued at a very low-interest rate, but that is no longer universally true. If a borrower fails to repay a policy loan, the money is withdrawn from the insurance death benefit.

1.7. Claim Settlement: Payment of claim is the ultimate objective of life insurance and the policyholder has waited for it for a quite long time and in some cases for the entire life time literally for the payment. It is the final obligation of the insurer in terms of the insurance contract, as the policyholder has already carried out his obligation of paying the premium regularly as per the conditions mentioned in the schedule of the policy document. The policy document also mentions in the schedule the event or events on the happening of which the insurer shall be paying a predetermined amount of money.

There may be three types of claims in life insurance policies–

1. **Survival Benefit Claim**
2. **Maturity Benefit Claim**
3. **Death Benefit Claim**

1. **Survival Benefit Claim**: Survival benefit is not payable under all types of plans. It is payable in endowment or money back plans after a lapse of a fixed period say 4 or 5 years, provided firstly the policy is in force and secondly the policyholder is alive.

   As the insurer sends out premium notices to the policyholder for payment of due premium, so it sends out intimation also to the policyholder if and when a survival benefit falls due. The letter of intimation of survival benefit carries with it's a discharge voucher mentioning the amount payable.

   The policyholder has merely to return the discharge voucher duly signed along with the policy document. The policy document is necessary for endorsement to the effect that the survival benefit which was due has been paid. The survival benefit can take different forms under different types of policies.

2. **Maturity Benefit Claim:** It is a final payment under the policy as per the terms of the contract. Any insurer is under obligation to pay the amount on the due date. Therefore, the intimation of maturity claim and discharge voucher are sent in advance with the instruction to return it immediately.

   If the life assured dies after the maturity date, but before receiving the claim, there arises a typical problem as to who is entitled to receive the money. As the policyholder was surviving till the date of maturity, the nominee is not entitled to receive the claim.

   The policy under such conditions is treated as a death claim where the policy does not have a nomination. The insurer in such a case shall ask for a will or a succession certificate, before it can get a valid discharge for payment of this maturity claim.

In case the policy has been taken under Married Women's Property Act, the payment of maturity claim has to be made to the appointed trustees, as the policyholder has relinquished his right to all the benefits under the policy. It is for this relinquishment of right that the policy money enjoys a privileged status of being beyond the bounds of creditors etc.

If the maturity claim is demanded within one year, before the maturity it is called a discounted maturity claim. This amount is much less than the maturity claim.

3. **Death Benefit Claim:** If the life assured dies during the term of the policy, the death claim arises. If the death has taken place within the first two years of the commencement of the policy, it is called an early death claim and if the death has taken after 2 years, it is called a non-early death claim.

1.8. The Insurance Act, 1938 (As Amended by Insurance (Amendment) Act, 2021): The Insurance Act, 1938 is a law originally passed in 1938 in British India to regulate the insurance sector. It provides the broad legal framework within which the industry operates.

The Insurance Act has 120 sections and 8 schedules. Under it, only an Indian company, as defined and registered under Companies Act, 1956, is allowed to operate in India. Its foreign entity-owned equity should not exceed 49% as of 2015. It must have a licence from Insurance Regulatory and Development Authority of India.

In March 2021, The Insurance (Amendment) Bill, 2021 was passed by the Parliament of India which increased the maximum permissible Foreign Direct Investment in the insurance sector to 74%, from the previous limit of 49%.

The Insurance (Amendment) Bill, 2021 was introduced in Rajya Sabha by the Minister of Corporate Affairs, Ms. Nirmala Sitharaman, on March 15, 2021. The Bill amends the Insurance Act, 1938. The Act provides the framework for functioning of insurance businesses and regulates the relationship between an insurer, its policyholders, its shareholders, and the regulator (the Insurance

Regulatory and Development Authority of India). The Bill seeks to increase the maximum foreign investment allowed in an Indian insurance company.

Foreign investment: The Act allows foreign investors to hold up to 49% of the capital in an Indian insurance company, which must be owned and controlled by an Indian entity. The Bill increases the limit on foreign investment in an Indian insurance company from 49% to 74%, and removes restrictions on ownership and control. However, such foreign investment may be subject to additional conditions as prescribed by the central government.

Investment of assets: The Act requires insurers to hold a minimum investment in assets which would be sufficient to clear their insurance claim liabilities. If the insurer is incorporated or domiciled outside India, such assets must be held in India in a trust and vested with trustees who must be residents of India. The Act specifies in an explanation that this will also apply to an insurer incorporated in India, in which at least: (i) 33% capital is owned by investors domiciled outside India, or (ii) 33% of the members of the governing body are domiciled outside India. The Bill removes this explanation.

1.9. Insurance Regulatory and Development Authority (IRDA): The Insurance Regulatory and Development Authority is the main organization or supervisory body that regulates the insurance sector in the country. It sets rules and regulations for the functioning of the insurance industry. Its sole purpose is to protect the interest of policyholders and to develop the industry on the whole.

The IRDA or IRDAI regularly issues advisories to insurance companies in case of changes to the rules and regulations. The regulator guides the insurance industry in promoting the efficiency in the conduct of insurance business all the while controlling the rates and other charges related to insurance. This article dwells on the functioning of the IRDA, features and benefits as well as answers to frequently asked questions at the end of this reading.

Establishment of IRDA:

The Government of India was the regulator for the insurance industry until 2000. However, to institute a stand-alone apex body, the IRDA was established in 2000 following the recommendation of the Malhotra Committee report in 1999. In August 2000, the IRDA began accepting applications for registrations through invites and allowed companies from other countries to invest up to 26% in the market.

The IRDA has outlined several rules and regulations under Section 114A of the Insurance Act, 1938. Regulations range from registration of insurance companies for operating in the country to protecting policyholder’s interests. As of September 2020, there are 31 General Insurance companies and 24 Life Insurance companies who are registered with the IRDA.

Objectives of IRDA:

The main objective of the Insurance Regulatory and Development Authority of India is to enforce the provisions under the Insurance Act. The mission statement of the IRDA is:

- To protect the interest and fair treatment of the policyholder.
- To regulate the insurance industry in fairness and ensure the financial soundness of the industry.
- To regularly frame regulations to ensure the industry operates without any ambiguity.

Important Role of IRDA in the Insurance Sector in India:

The insurance industry in India dates back to the early 1800s and has grown over the years with better transparency and focus on protecting the interest of the policyholder. The IRDA plays an integral role in emphasizing the importance of policyholders and their interest while framing rules and regulations. Here are the important roles of the IRDA:

- To protect the policyholder’s interests.

- To help speed up the growth of the insurance industry in an orderly fashion, for the benefit of the common man.
- To provide long-term funds to speed up the nation’s economy.
- To promote, set, enforce and monitor high standards of integrity, fair dealing, financial soundness and competence of the insurance providers.
- To ensure genuine claims are settled faster and efficiently.
- To prevent malpractices and fraud, the IRDA has set up a grievance redress forum to ensure the policyholder is protected.
- To promote transparency, fairness and systematic conduct of insurance in the financial markets.
- To build a dependable management system to make sure high standards of financial stability are followed by insurers.
- To take adequate action where such high standards are not maintained.
- To ensure the optimum amount of self-regulation of the industry.

Functions of IRDA: Below are the important functions of the IRDAI in the insurance industry in India:

- Grant, renew, modify, suspend, cancel or withdraw registration certificates of the insurance company.
- Protecting the interests of the policyholder in matters concerning the grant of policies, settlement of claims, nomination by policyholders, insurable interest, surrender value of the policy and other terms and conditions of the policy.
- Specify code of conduct, qualifications and training for intermediary or insurance agents.
- Specify code of conduct for loss assessors and surveyors.
- Levying fees and charges for carrying out the provisions of the Act.
- Undertaking inspection, calling for information, and investigations including an audit of insurance companies, intermediaries, and other organizations associated with the insurance business.
- Regulate and control insurance rates, terms and conditions, advantages that may be offered by the insurance providers.

Apart from the above-mentioned core functions of the IRDA, there are several functions that the regulator performs keeping the policyholder's interest as its priority.

How Does IRDA Work?

The apex body of the insurance industry, the IRDA, ensures it frames rules and regulations without any ambiguity towards any particular insurance company. To ensure fairness and the financial soundness of the industry, the main work of IRDA revolves around the policyholder's interests. Refer to the following roles that the IRDA is mainly involved in:

- Issue's certificate of registration to new insurance companies.
- Sets rules and regulations to ensure the interests of the policyholder are taken care of.
- Monitors all claims are settled in all fairness and that no insurer will deny any claim on their own free will.
- Regulates the code of conduct of the insurance companies, insurance intermediaries, and others associated with the insurance industry.
- Provides solutions in case of disputes through the IRDA ombudsman.
- Controls and regulates the rates of insurance to prevent unwanted price hikes in the insurance premium.
- The apex body is responsible for setting the minimum percentage limit of insurance companies for General and Life Insurance, thereby developing both urban and rural sectors.

Features & Benefits of IRDA: Following are the salient features of the apex body, the Insurance Regulatory and Development Authority of India:

- Acts as a regulator for the insurance industry.
- Protects the policyholder's interests.
- Rules and regulations are framed by the apex body under Section 114A of the Insurance Act, 1938.

- It is entrusted under the Insurance Act to grant the certificate of registration to new insurance companies to operate in India.
- Oversees the insurance industry's activities to ensure sustained development of insurers and policyholders.

Types of Insurances Regulated by the IRDAI: Insurance is mainly divided into Life and Non-Life/General Insurance. These are further classified into other types of insurance. Below are the types of insurance regulated by the IRDAI:

- Life Insurance
- Term Plans
- Endowment Policies
- Unit-linked Insurance Policies
- Retirement Policies
- Money-back Policies
- General Insurance
- Health Insurance Policies
- Vehicle/Motor Insurance Policies
    - Car insurance
    - Bike Insurance
- Property Insurance Policies
- Travel Insurance Plans
- Gadget Insurance Plans

New Rules and Guidelines for Health and Mediclaim Insurance by IRDA: The IRDA is the apex body which is responsible for framing new rules and guidelines for health insurance in the country. The regulator has issued new IRDA rules for health and Mediclaim insurance in 2020, and they are:

i) **Rejection of Claims:** The insurer cannot reject a claim if the policyholder has renewed the policy for eight years without any break or lapse. This period will be known as the moratorium period. The insurer cannot appeal to the IRDA for the rejection of the claim except in case of fraud or in case the claim is raised against the exclusion of the policy.

ii) **Inclusion of Telemedicine:** With the advent of digitalization, the medical service has changed and one can consult a doctor through online consultations. IRDA has asked insurers to include telemedicine consultations in the insurance policy.

iii) **Settlement of Claims:** If the insurer delays settling the claim, then the insurance company is liable to pay interest on the claim amount. It should ensure the claim is settled within 30 to 45 days from the submission of the last document by the policyholder.

Short Answer Questions (2 Marks)

1. What is Nomination?
2. What is Assignment?
3. What is Surrender Value?
4.What is Policy Loan?
5.What is IRDA?

Essay Type Questions (6 Marks)

1. What is the procedure for taking a Life Policy?
2. Write about Claim Settlement?
3. What are the functions of IRDA?

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BANKING AND RETAIL MANAGEMENT
2ND YEAR PAPER – I
BANKING AND INSURANCE - II (THEORY)
MODEL QUESTION PAPER

Time: 3Hrs **Max Marks: 50**

SECTION - A

Answer **All** the Questions Each Question Carries **Two** Marks. 10×2=20

1. What is Money Market?
2. What is PMJDY a/c?
3. What is meant by Term Loan?
4. What is MUDRA Loan?
5. What is Revolving Fund?
6. What is Clearing House?
7. Expand EFT, ECS, RTGS, IMPS?
8. What is Intra Bank Transfer?
9. Write any two services of Insurance Agencies?
10. What is Surrender Value?

SECTION – B

Answer any **Five** of the following. Each Question Carries **Six** Marks. 5×6=30

11. Write the structure of Indian Money Market?
12. Write about various types of Bank Deposits?
13. What are the considerations taken by bank for granting loans?
14. What are the duties and responsibilities of Business Facilitator?
15. Write about Cheques Clearing Process?
16. What are the features of Debit Card?
17. What is the need of Insurance Agent to the Public?
18. What is the procedure for issuing of Life Insurance Policy?

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BANKING AND RETAIL MANAGEMENT (BRM)

SECOND YEAR PAPER – II

BUSINESS ACCOUNTANCY – II

INDEX

UNIT – I

ACCOUNTS OF NON – TRADING CONCERNS

Accounts of Non-Trading Concerns: Meaning - Capital Expenditure and Revenue Expenditure – Capital Receipts and Revenue Receipts – Preparation of Final Accounts: Receipts and payments account – Income and expenditure account – Exercises.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand about Capital Expenditure and Revenue Expenditure
- ☞ Understand about Capital Receipts and Revenue Receipts
- ☞ Prepare Final Accounts

1. Introduction: There are certain organisations which are set up for providing service to its members and the public in general. Such organisations include clubs, charitable institutions, schools, religious organisations, trade unions, welfare societies and societies for the promotion of art and culture. These organisations have service as the main objective and not the profit as is the case of organisations in business. Normally, these organisations do not undertake any business activity, and are managed by trustees who are fully accountable to their members and the society for the utilization of the funds raised for meeting the objectives of the organisation. Hence, they also have to maintain proper accounts and prepare the financial statement which take the form of Receipt and Payment Account; Income and Expenditure Account; and Balance Sheet at the end of for every accounting period (normally a financial year).

This is also a legal requirement and helps them to keep track of their income and expenditure, the nature of which is different from those of the business organisations. In this chapter we shall learn about the accounting aspects relating to not-for-profit organisation.

1.2. Meaning: Those organisations which are service motive is called Non – Trading Concerns. E.g., Hospitals, Libraries, Clubs, Charitable Trusts etc., Non - Trading

Organisations refer to the organisations that are for used for the welfare of the society and are set up as charitable institutions which function without any profit motive. Their main aim is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence, they need not maintain many books of account (as the trading concerns do) and Trading and Profit and Loss Account.

The funds raised by such organisations are credited to capital fund or general fund. The major sources of their income usually are subscriptions from their member’s donations, grants-in-aid, income from investments, etc. The main objective of keeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

1.3. Accounting Records of Non - Trading Organisations: The final accounts of a Non – Trading Concerns consist of the following:

a. Receipt and Payment Account
b. Income and Expenditure Account, and
c. Balance Sheet

1.4. Capital and Revenue Items: One of the objects of accounting is to determine whether the business has earned profit or not. For this purpose, a proper distinction has to made between capital and revenue as regards expenditure, receipts and losses are required. Failure to distinguish capital from revenue will affect the whole results. For example, plant purchased may be charged to the purchase account, proceeds from the sale of fixed assets may be treated as income. In each case both the profit and loss account and balance sheet will be affected. While preparing the final accounts all revenue items are included in the revenue account i.e., Income and expenditure account and balance sheet. Any more committed in distinguishing between “Capital” and “Revenue” will affect the ascertainment of correct profit.

It is very difficult to give clear cut rules as to make a distinction between the capital and revenue expenditure. However, the following rules may serve as guide for making distinction between capital and revenue expenditure.

Capital Expenditure: Capital expenditure is such an expenditure which benefits the business over a long period it includes assets acquired for the purpose of earning and not for resale, improving extending fixed assets, increasing the earning capacity of the business and rising capital for the business. Purchase of new plant, additions to the buildings, brokerage and commission paid for procuring long term loans are a few examples of such expenditure. All items of capital expenditure appear on the assets side of the balance sheet.

Usual items of capital Expenditure: The following items usually represent capital expenditure:

- Cost of acquisition of fixed assets like goodwill, land building, leasehold premises, tools and equipment, furniture, trademarks etc.
- Expenses of putting a new asset in working condition like installation and erection expenses of any fixed asset.
- Additions or extensions or structural improvement to the existing assets leading to increase in their working efficiency or revenue earning capacity or cost reduction e.g., refurnishing of the seating accommodation of a cinema hall etc,
- Expenses incurred for the development of mines and plantation.
- Formation expenditure of a business i.e., preliminary expenses like preparing and filling the legal documents required for starting a business etc.

Capital Receipts: Receipts which are not of revenue nature are called Capital Receipts. E.g., sale of old assets, life membership fee, legacies, special donations etc. Capital receipts are shown in the liabilities side of the Balance Sheet.

Revenue Expenditure: Revenue expenditure is the expenditure incurred in one accounting period and the full benefit it enjoyed in the same period. Therefore, it is normally of recurring nature. Such an expenditure does not increase the earning capacity of the business and is done not bring into existence and assets. It includes expenses incurred for acquiring assets for resale at a profit or for conversion into finished product, for maintaining fixed assets in good working order e.g., normal repairs and renewal of plant, White washing of building replacement of machinery etc., for keeping the organization going e.g., rent, rates and taxes wages and salaries, insurance and other trade charges. All items of revenue expenditure appear in the trading and profit and loss account.

Usual items of Revenue Expenditure: The following are usual items of revenue expenditure

- Expenses incurred in the ordinary conduct and administration of the business e.g., rents, salaries, wages, advertisement etc.
- Expenses incurred in purchasing raw material or stock finished goods for resale store and supplies like grease, cotton, oil for machines etc.
- Expenses incurred to maintain assets in working order like ordinary repairs, renewals or alterations etc.
- Expenses incurred in maintaining or pushing sales like carriage of finished goods commissions travelling expenses, free samples and gifts etc.
- Loss arising from sale of fixed assets.
- Loss arising from damage, destruction, theft of stock, trade cash etc.
- Loss arising from depreciation in the values of fixed assets or book value of asset discarded.
- Annual renewal fees of patents etc.

Revenue Receipts: The receipts which are received by the business organisation in the course of normal activities are Revenue Receipts. E.g., cash from sale, discount received, commission, interest on investment etc. In case of clubs and association, annual subscription, sale or games articles, receipts, arising when the premises are given to others for use, are revenue receipts. Revenue receipts are shown in the revenue account i.e., Income and Expenditure account.

1.4.1. Treatment of Revenue Expenditure Becoming Capital Expenditure: An expenditure which is primarily of revenue nature but incurred for the purpose of acquiring any asset or adding to its value, is termed as 'capitalized expenditure'. The following are some of the examples of revenue expenditure becoming capital expenditure.

1. **Repairs:** Repairs are usually revenue expenditure but, if we purchase a second-hand machinery and pay for repairs necessary as 'capitalized expenditure'.
2. **Wages:** Wages are usually based as a revenue charge but if paid to the employees for the construction or erection or installation of fixed assets of the business, them these will become capital expenditure and should be added to the cost of the fixed asset concerned.
3. **Legal Expenses:** These are usually a revenue charge but, if incurred on acquiring a property, should be added to the cost of the asset acquired cost of the asset.
4. **Freight And Carriage:** These are usually a revenue item, but payments made for transporting newly acquired asset will be treated as a capital expenditure and will from additional cost of the asset.
5. **Interest:** Interest on borrowing and capital are generally a revenue item and is allowed to be treated as capital item if paid during the period of construction.
6. **Preliminary expenses:** Initial expenses, connected with the formation of a company through revenue in nature are allowed to be capitalized and can be shown as an asset in the balance sheet.
7. **Brokerage and stamp duty:** Normally these are revenue items, but brokerage and stamp duty paid on the purchase of a property may be treated as capital expenditure.
8. **Development expenditure:** In concerns like mines, tea plantations, collieries, horticulture rubber plantation etc. a sizeable is spent during the period of development and such expenses incurred upto the time they begin to earn, must to be treated as capital expenditure.
9. **Advertising:** A huge sum spent on advertising in a year, the benefit of which shall accrue in future years, also may have the effect of creating a future goodwill, therefore such sums may be capitalized. For example, lakhs of rupees spent in changing the name from Fair and Lovely to Glow and Lovely.

10. **Raw materials and stores:** They are usually a revenue charge, but if consumed to make a fixed asset, they must be treated as part of the cost of the asset.

1.4.2. Deferred Revenue Expenditure: It is the expenditure which would normally be treated as revenue expenditure, but it is not written off in one year as a benefit is not completely exhausted in the year during which it is incurred at it may as it may be spread over a number of years. Therefore, a proportionate amount will be charged to the profit and is account of each year and the balance is carried forward to subsequent years as deferred revenue expenditure and is shown as an asset in the balance sheet. Sometimes extra ordinary losses are also treated as deferred revenue expenditure and charged to profit and loss account for four to five years.

1.5. Receipts and Payments Account: It is summary of cash transaction at the end of particular period showing the receipts and payments of cash during the period under different heads.

The features of this account are:

1. It is prepared by non-trading concerns in lieu of cash book.
2. It is real account.
3. Its start with the opening balance of cash in hand and at the bank.
4. All receipts and payments of cash are entered on the debit and credit side respectively.
5. No distinction is made between the capital and revenue items while entering transactions in the receipts and payments account.
6. All receipts and payments whether they are relating to the current, proceeding or succeeding period are written in this account.
7. Opening balance of this account cash in hand at the beginning of the accounting period and closing balance shows cash in hand at the end of accounting period.
8. All types of accounts i.e., real and nominal are written in this account.
9. No adjustment for outstanding, prepaid expenses provisions for doubtful debts or depreciations are made in this account it is prepared in cash system of accounting.

10. It does not reveal the financial results or the financial position of the association or clubs because accrued incomes and outstanding expenses are not taken into account.

1.5.1. A Specimen of The Receipt and Payments Account:

Receipts and Payments Account of……for the year ending 31.03.2021

Dr. **Cr.**

Receipts	₹	Payments	₹
To Balance b/d	xxx	By Rent	xxx
To Subscriptions	xxx	By Fixed Assets	xxx
To Entrance fee	xxx	By Sports material purchased	xxx
To Legacy	xxx	By Building	xxx
To Donations for building	xxx	By Ground maintenance	xxx
To Interest received	xxx	By Salaries	xxx
To Sale of furniture	xxx	By Honorarium	xxx
To Sale of old Sports materials	xxx	By Stationary	xxx
To Match fund	xxx	By Investments	xxx
To Life membership fees	xxx	By Balance c/d	xxx
	xxx		xxx
To Balance b/d	xxx		

Illustration 1: Stadium club kept its account on cash basis and the figures for the year ended 31.03.2021 are given below. You are required to prepare Receipts and Payments Account.

	₹		₹
Subscription Received			
2017	800	Salaries	4,800
2018	7,200	Postage	480
Receipt from		Stationary	1,200
Common Room	5,000	Rent	2,000
Hiring Rooms	400	Cash in hand	
Billiards Rooms	2,400	01-01-2018	720
Supplies from		Electricity	1,600
Entertainment room	3,400		
Wages to Watchman’s	2,720		

Receipts And Payments Account of Stadium Club

for the year ended on 31st March, 2021

Receipts	₹	Payments	₹
To Balance b/d	720	By Supplies for entertainment	3,400
To Subscriptions		By Watchman's wages	2,720
2020	800	By Salaries	4,000
2021	7,200	By Postage	480
To Receipt from c. room	5,000	By Stationary	1,200
To Hiring of rooms	400	By Rent	2,000
To Billiards rooms	2,400	By Electricity	1,600
		By Balance c/d	1,120
	16,520		16,520
To Balance b/d	1,120		

1.6. Income And Expenditure Account: It is prepared by non-trading concerns of profit and loss account to know whether during a particular period the income of the concerns or organization has exceeded or fallen short of the expenses, this account is prepared. In this account current expenses are compared with current incomes. The features of this account are:

- It is not start with any opening balance.
- It is a nominal account. Expenses are shown in the debt side and incomes in the credit side.
- Only revenue items are recorded in it. Capital items are totally excluded.
- Only incomes and expenses of the concerned year are recorded in it and income and expenditure relating to the proceeding or succeeding periods are included while preparing this account.
- This account is prepared on mercantile system of accountancy. Therefore, all adjustment relating to the preceding or succeeding periods are excluded while depreciations and doubtful debts will be made.
- Only adjustment accounts are taken into consideration for the preparations of this account. For personal and real accounts, a balance sheet must be prepared along with this account.
- The balance in the account shows either surplus i.e., excess of income over expenditure or deficit i.e., the excess of expenditure over income.

1.6.1. Differences Between Receipts and Payments A/C and Income & Expenditure A/C

Receipts and Payments Account	Income and Expenditure Account
1. It is a real account	It is a nominal account
2. It is like cash book prepared by trading Concerns.	It is like profit and loss account Prepared by trading concerns.
3. It starts with a balance being cash at the beginning of the year	It does not start with any opening balance.
4. Receipts are shown on the debit side and Payments on credit side.	Income are shown on the credit side and expenditure on the debit side.
5. All times whether of capital or revenue nature is shown in this account.	Only revenue items are shown in this account.
6. All receipts and payments whether they are of preceding current or succeeding period are entered in it.	Income and expenditure of the current year are shown in it.
7. Outstanding receipts and payments are not shown in it as it is prepared on cash basis.	Income and expenses are shown after including outstanding income and expenses on accrual basis.
8. The closing balance represents cash in hand on that date.	The closing balance represents surplus or deficit for the period.
9. It is not necessary to prepare balance sheet along with this account.	In addition to this account balance sheet must be prepared in order to accommodate real and personal account.

1.6.2. A Specimen of Income and Expenditure Account: A specimen of Income and Expenditure Account is given below:

Income and Expenditure Account for the year ended…………

Dr. **Cr.**

Expenditure	₹	Income	₹
To Salaries	xxx	By Subscriptions	xxx
To Honorarium	xxx	By Interest on Securities	xxx
To Wages of Grounds men	xxx	By Proceeds of entertainment and lectures	xxx
To Upkeep of Ground	xxx	By Rent of Hall	xxx
To Printing and Stationary	xxx	By Grant from Government, Local authorities	xxx
To Postage	xxx	By Interest on Deposits	xxx
To Telephone charges	xxx	By General Donations (Small amount)	xxx
To Lighting	xxx	By Entrance Fees (if not capitalized)	xxx
To Bank Charges	xxx	By Advertisement in Year Book	xxx
To General Expenses	xxx	By Locker Rent	xxx
To Rent, Rates and taxes	xxx	By Sale of grass	xxx
To Insurance	xxx	By Profit on sale of asset	xxx
To Audit Fees	xxx	By Miscellaneous Receipts	xxx
To Cost of entertainment	xxx	By Excess of Expenditure over	
To Subscription to periodicals	xxx	Income (Deficit)	xxx
To Sports materials used	xxx		
To Depreciation	xxx		
To Repairs	xxx		
To Loss on sale of assets	xxx		
To Excess of Income over Expenditure	xxx		
	xxx		xxx

1.6.3. Preparation of Income and Expenditure account from Receipts and Payments Account: The following steps are to be taken to convert a Receipt and Payments account into an Income and Expenditure account.

- Leave the opening and closing balance of cash given in the receipts and payments account.
- Only revenue items income and expenditure should be taken leaving all those items which are of capital nature.

- Make all adjustment for outstanding and prepaid incomes and expenses, provision for depreciations or bad debts etc.
- Take items of the current period only i.e. items relating to the proceeding and succeeding periods are to be ignored.
- In the Incomes and Expenditure account, expenditure is recorded in the debit side and income is recorded on the credit side.
- Once income and expenditure account is balanced it shows either surplus or deficit If credit balance is more than debit balance it is called ‘Surplus’ and if the debit balance is more than credit balance it is called as ‘Deficit’.

Illustrations 2: For the following particulars, prepare income and expenditure account of Hyderabad Golf Club for the year ending 31 March, 2021.

Particulars	₹
Subscriptions received for 2020-2021	11,000
Entrance fees received for 2020-2021	1,500
Subscriptions and entrance fee for 2019-2021 realized	560
Subscriptions and entrance fees for 2022	3,100
Miscellaneous fees	4,200
Expenses for 2020-2021	14,000
Expenses unpaid	460
Audit fees for 2020-2021 not paid	400
Interest on Loan Paid	640
Capital expenditure in 2020-2021	4,120
Provide for depreciations for this year	340
Cash in hand	3,600

Solution:

Hyderabad Golf Club Income and Expenditure Account

for the year ended 31st March, 2021

Expenditure	₹	₹	Income	₹	₹
To Expenses	14,000		By Subscriptions		11,000
Add: Unpaid	460	14,460	By Entrance Fee		1,500
To Audit fees		400	By Miscellaneous fees		4,200
To Interest loan		640			
To Depreciation		340			
To Surplus (c/d)		860			
		16,700			16,700

Some Special Terms Pertaining to Non-Trading Organization: While preparing final accounts of non-profit organizations the following items are often used.

1. **Legacy:** When an account is received as per will of some person, it is called ‘Legacy’. As its non-recurring and capital in nature it is to be capitalized. But if the amount is small, it can be taken as an income.

2. **Donations:** Donations are often received by these organizations from both individuals and institutions. Donations is the amount received as a gift. Donations may be broadly classified into two categories viz; specific donations and general donations.

a. **Specific Donations:** A donations received for a specific purpose, whether big or small is capitalized an is taken to the liabilities side of the balance sheet. For example, a donation for the construction of a building. This amount should be utilized only for the purpose for which it is received i.e., construction for building.

b. **General Donations:** A general donation is the amount given by parties without specifically mentioning the purpose for which it should be utilized. This amount can be spent for any purpose. However, normally general donation of big amounts is capitalized and small amounts are treated as revenue income.

3. **Endowment Fund:** Endowment is the money or property given by parties so as to provide a permanent source of income to support the institution. For ex. The corpus fund of university. Since the fund provides a permanent means of support any amount received on account of this is capitalized and shown as a Liability. But the in interest or divided received on account of this fund is treated as revenue.

4. **General Fund:** Amount which are received for no Specific purpose and which are capitalized are shown under this head on the liabilities side of the balance sheet But the income obtained on account of this fund is taken to the credit side of income and expenditure account.

5. **Specific Funds:** Amount which are received for no Specific purpose are capitalized are shown in the balance sheet on its liabilities side e.g., prize fund, buildings fund. Receipts and income on account of these specific fund should beaded to the fund account and should not be taken to income and expenditure account. All expenses on account of these funds should be deducted from the particular fund in the balance sheet only. In case the expenses exceed the fund amount the excess expenses should be charged to the debit side of the income and expenditure amount.

6. **Subscription:** Amount agreed to the paid by the member or subscribers regularly at periodical interval are called 'Subscription'. They are a regular source of income to the organization. Hence subscription is shown as income.

7. **Admission or Entrance Fees: This** is the amount received from a member at the time of his initial admission or readmission into the organization. There is a different of opinion about the treatment of this items in account. Some people argue that is should be capitalized. Since it is not a recurring item as each member pay it once only. However, there are others who argue that, though it is paid by each member only once the club or association received it regularly therefore it should be treated as income. Leaving the arguments, a side, in the absence of specific instructions to capital entrance of admission fee must be treated as revenue income i.e., shown in the credit side of income and expenditure account.

8. **Honorarium:** It is taken payment made to certain people for their services. It is regularly treated as revenue expenditure and charged to the Income and Expenditure account. But if the amount is paid on account of a specific programme conducted in connection with a specific fund, the amount should be deducted from the specific fund in the balance sheet.

9. **Sale of Old Asset:** Any receipt from the sale of old asset such as furniture is a capital receipt and as such it should not be taken income and expenditure account. It should be deducted for the concerned asset in the Balance sheet.

However, any loss on the sale of asset in charged to income and expenditure amount. In case of gain on the sale of an asset, if the amount is small, it is taken to the income and expenditure account, but if it is a big, it is treated as a capital gain and shown in the Balance Sheet.

10. **Sale of Old Newspapers:** The amount received of in account of selling old newspapers or old sport materials etc, is treated as revenue income.

Short Answer Questions (2 Marks)

1. What is non – trading business concerns?
2. How many types of final accounts prepared by non – trading concerns? What are they?
3. What is Revenue Expenditure?
4. What is Deferred Revenue Expenditure?
5. What is Capital Expenditure?
6. What is meant by Donations?
7. What is meant by Legacy?
8. What is meant by Entrance Fees?

Essay Answer Questions (6 Marks)

1. What are the differences between receipts & payments account and income and expenditure account?

Exercises

1. From the following particulars prepare Receipts and Payments account.

Particulars	₹
Cash in hand	1,000
Cash at Bank	5,000
Subscription received	33,000
Donations received	2,600
Investments purchased	10,000
Rent Paid	4,000
General expenses	2,000
Postage & Stationary	700
Sundry expenses	300
Cash balance at cost	200

(Ans: Closing Bank Balance ₹24,300)

2. Prepare Receipts and Payments account from the following particulars: -

Particulars		₹
Opening balance of cash in hand		1,800
Rent Paid		450
Stationary purchased		540
Subscription received		2,600
Previous year	1,800	
Current year	4,500	5,580
Honorarium Paid		810
Sale of old furniture		1,890
Flood relief expenses		684
Repairs		756

(Ans: Cash balance ₹6,300)

3. From the following particulars prepare Income and Expenditure account.

Particulars	₹
Fee collected (including Rs.24,000on account of last year)	2,24,000
Fee outstanding for current year	40,000
Advertisement	3,200
Salary Paid (including Rs.2,400 on account of last year)	19,200
Salary outstanding (current year)	4,000
Tournament expenses	8,000
Meeting expenses	16,000
Travelling & Conveyance	6,000
Purchase of books	16,000
Periodicals	8,000
Rent	9,600
Postage, Telephone and Telegrams	13,600
Printing & Stationary	4,000
Donations received	6,400

(Ans: Surplus ₹1,56,800)

4. Following is the Receipts and Payments account of Vishakhapatnam cultural club for the year ended 31.12.2018.

Receipts	₹	Payments	₹
To Donation	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300
To Sports competition fund	5,000	By Tennis	270
To Subscription	1,600	By Insurance	180
(Including Rs.50 for 2018)		By Billiards	85
To Locker rent	50	By Printing	15
To Interest on securities	200	By Telephone	125
To Cricket	150	By Investments	9,000
To Billiards	100	By Balance c/d	23,325
To Tennis	100		
	34,200		34,200
To Balance b/d	23,325		

Subscription received for 2018 Rs.150, outstanding salaries, Rs.100. Half of the donations are to be capitalized, accrued interest Rs.300. Prepaid Insurance Rs. 30. Prepare Income and Expenditure account for the year ended 31.12.2018.

(Ans: Surplus ₹13,155)

5. From the following Receipts and Payments accounts of Youth Society prepare an Income and Expenditure account for the year ended 31.3.2019.

Dr. Receipts and Payments Account for the year ended 31.3.2019 Cr.

Receipts	₹	Payments	₹
To Balance b/d	3,485	By Books	6,150
To Entrance fee	650	By Printing & Stationary	465
To Donations	6,000	By News Papers	1,110
To Subscriptions	6,865	By Sports Material	5,000
To Interest on Investment	1,900	By Repairs	650
To Sale of furniture	685	By Investments	2,000
To Sale of old news paper	465	By furniture	1,000
To Proceeds from entertainment	865	By Salaries	1,500
To Miscellaneous receipts	125	By Balance c/d	3,165
	21,040		21,040

The Entrance fees and Donations are to be capitalized. Sports materials are valued at Rs.4,000 on 31.3.2019.

(Ans: Surplus ₹5,495)

6. From the following Receipts and Payments account for the year ending 31.3.2021. Prepare an income and expenditure account for the period ending 31.3.2021.

Dr. Receipts and Payments Account Cr.

Receipts	₹	Payments	₹
To Donation received	35,000	By Salaries	37,500
To Subscriptions	115,000	By Help to poor students	37,000
To Life membership fee	50,000	By Expenses on fee dispensary	34,500
To Legacy	75,000	By Postage and Stationery	3,500
To Interest Received	4,000	By Furniture	50,000
		By Investments	75,000
		By Cash in hand	41,500
	279,000		279,000

Additional Information:

1. Subscription outstanding for the year Rs. 5,000.
2. Salaries unpaid Rs. 5,000.
3. Help to poor students promised but unpaid Rs. 16,000.
4. Expenses of dispensary outstanding Rs. 3,000.
5. Postage and Stationary expenses yet to be paid Rs. 4,000.

(Ans: Surplus: ₹ 18,500)

7. Vijayawada sports club was started on 1.4.2018. Their Receipts and Payments a/c for the year 2018-2019 is given below.

Adjustments:

1. Subscription receivable for the year Rs. 300.
2. Salaries Unpaid Rs. 170.
3. Entrance fee is to be capitalized.
4. Insurance is for one year and is premium paid up to 31st Dec 2019.
   Prepare the income and Expenditure account for 2018-2019.

Receipts	₹	Payments	₹
To Donation received	50,000	By Buildings	40,000
To Entrance fee	4,000	By Tournament expenses	900
To Tournament fund	10,000	By Furniture	2,100
Revenue Receipts		**Revenue Payments**	
To Subscriptions	3,200	By Salaries	1,800
(Incl. Rs.100/- for 2017 -18)	100	By Cricket expenses	1,140
To Rent	700	By Insurance	360
To Other Receipts	400	By Gardener salary	600
To Cricket fee		By Investments	18,000
		By Balance c/d	3,500
	68,400		68,400

(Ans: Excess of income over expenditure ₹800)

8. The Receipts and Payments account of the Hyderabad Friends Club for the period ending 31.3.2018 is given below.

   Subscription fee outstanding for the year 2017-2018 Rs.150. Salaries unpaid for the year Rs. 85. From the above particulars prepare an income and Expenditure account of the club for the year ended 31.3.2018 and the balance sheet in that date.

Receipts	**₹**	**Payments**	**₹**
To Donation received	25,000	By Buildings	20,000
To Reserve Fund	2,000	By Furniture	1,050
(Being life membership fee received)		By Tournament expenses	450
To Match fund	5000	from match fund	
Revenue Receipts		**Revenue Payments**	
To Subscriptions	1,600	By Salaries	900
(Incl. Rs.50 for 2016-17)		By Cricket	300
To Lockers Rent	50	By Tennis	270
To Interest on securities	50	By Insurance (paid up to 31st Dec, 2018)	180
To Cricket	200	By Gardening	85
To Sundries	25	By Printing	15
To Tennis	175	By Telephone	125
To Billiards	100	By Sundries	75
		By Investments (at cost)	9,000
		By Balance c/d	1,750
	34,200		34,200

(Ans: Excess of Income Over Expenditure ₹400.)

9. Tarnaka Sports Club's Receipts and Payments account for the year ending 31.3.2019 is given here under.

   Additional Information:

   1. Subscription receivable for 2017-2018 were Rs.1000/- and for 2018-2019 Rs. 1,050.
   2. Games equipment in the beginning was Rs.1,000/- and at the end Rs. 1,250/-
   3. Provide depreciations at 10% on grass cutting machine.

   Prepare Income and Expenditure for the year ending 31.302019 and opening and closing balance sheet.

Receipts	₹	Payments	₹
To Cash in hand	250	By Salary to workmen	2,000
To Cash in Bank	2,250	By Grass cutting machine	1,000
To Subscription	6,750	By Rent	450
To Tournament fund	2,500	By Games expenditure	3,500
To Life membership fee	1,500	By Tournament expenditure	1,000
To Entrance fee	250	By Office expenditure	2,250
To Donation for pavilion	4,000	By Games equipment	1,500
To Sale of grass	200	By Balance c/d	
		Cash in Hand	750
		Cash at Bank	5,250
	17,700		17,700

(Ans: Deficit ₹2,300.)

10. Prepare Income and Expenditure account and balance sheet of Hyderabad Club from the particulars is given below for the year ending 31.3.2019.

Receipts	₹	Payments	₹
To Balance b/d	1,200	By Salaries	6,500
To Subscriptions	6,400	By Rent	1,200
(Including Rs.400 2017-18)		By Printing & Stationary	180
To Interest on investment	2,500	By Postage	50
(Investment cost Rs.40,000)		By Cycle purchased	800
To Bank Interest	50	By Govt. Bonds	1,000
To Sale of furniture	500	By Balance c/d	920
	10,650		10,650

Additional Information

1. Subscription received included Rs.200 of 2017-2018.
2. Rent paid included Rs.100 for March 2019 monthly rent is Rs.100.
3. Subscription due for 2017-2018 Rs.300.
4. Salaries Payable sold was Rs.600.
5. Cost of furniture sold was Rs.640.

(Ans: Deficit: ₹20)

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UNIT – II

HIRE PURCHASE SYSTEM

Hire purchase System: Features – Difference between Hire purchase and Installment purchase systems - Accounting Treatment in the Books of Hire Purchaser and Hire Vendor.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand about Features of Hire Purchase System
- ☞ Understand about the differences between Hire Purchase System and Installment Purchase System
- ☞ Understand about Accounting Treatment

1. Introduction: Hire purchase is a mode of financing the price of the goods to be sold on a future date. In a hire purchase transaction, the goods are let on hire, the purchase price is to be paid in installments and hirer is allowed an option to purchase the goods by paying all the installments. Hire purchase is a method of selling goods. In a hire purchase transaction, the goods are let out on hire by a finance company (creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes on to the hirer on the payment of the last installment.

1.1. Features of Hire Purchase Agreement:

i) **Hire purchase agreement**: All the required terms and conditions between both the parties involved are documented in a contract called Hire-Purchase agreement.

ii) **Initial deposit/down payment**: The hirer, usually, pays a certain amount as an initial deposit/down payment while signing the agreement.

iii) **Immediate possession**: Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.

iv) **Hire charges**: Each installment is treated as hire charges.

v) **Ownership in goods**: The ownership of the goods passes on the hirer on the payment of last installment.

vi) **Repossession**: In case the buyer makes any default in the payment of any installment the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charge.

vii) **Return of goods**: The hirer has the right to terminate the agreement any time before the property passes. He has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the sums already paid as such sums legally represent hire charge on the goods in question.

viii) **Depreciation:** Depreciation and investment allowances can be claimed by the hirer even though he is not an exact owner.

1.2. Differences between Hire Purchase System and Installment Purchase System:

Hire Purchase System	Installment Purchase System
1. It is governed by Hire Purchase Act, 1972.	It is governed by Sale of Goods Act, 1930.
2. It is an agreement of hiring.	It is an agreement of sale.
3. The parties to the contract are called Hire Purchaser and Hire Vendor.	The parties to the contract are called Buyer and Seller.
4. The ownership of the goods is transferred to the purchaser only after the payment of all installments.	The ownership of the goods is transferred to the buyer as soon as the contract is signed.
5. On default of payment of any installment by the purchaser, the seller can repossess the goods.	On default and payment of any installment by the buyer, seller cannot repossess the goods, but can file a suit in the court of law against the buyer for the recovery of unpaid price.
6. The relationship between hire purchaser and hire vendor is that of a Bailee and a Bailor.	The relationship between the buyer and seller is that of Debtor and Creditor till last installment is paid.

7. The purchaser cannot hire out, sell, transfer, pledge, destroy the goods.	The buyer can hire out, sell, transfer, pledge the goods, even if all installments are not yet paid.
8. In case of default, the total installments paid is forfeited and treated as Hire Charges.	In case of default, total amount of installment paid by the buyer cannot be forfeited.
9. The purchaser may return goods without further payment, except for installments already due.	Unless there is default on the part of the seller, goods cannot be returned.

1.3. Terms used in Hire Purchase Agreement:

i) Hire Vendor: The seller of the goods under hire purchase agreement is called Hire Vendor.

ii) Hire Purchaser: The buyer of goods in hire purchase agreement is called Hire Purchaser.

iii) Cash Price: Cash Price means the price at which the goods may be purchased by the Hirer for cash.

iv) Hire Purchase Price: The total amount payable by hire – purchaser to hire vendor under the hire purchase agreement is called Hire Purchase Price. The hire purchase price will be more than cash price, because in addition to cash price, interest (or finance charges) are also included in the price.

v) Down Payment: Down Payment means the initial payment payable by the hire purchaser at the time of entering into hire purchase agreement.

1.4. Accounting Treatment:

In the books of Hire Purchaser: There are two methods of recording hire purchase transactions in the books of the hire purchaser:

i) When the asset is recorded in full cash price-: Full Cash Price Method

ii) When the asset is recorded at cash price actually paid in each installment-: Actual Cash Price Method.

First Method (Full Cash Price Method):

Nature of Transaction	**In the books of Hire Purchaser**	**In the books of Hire Vendor**
5. For the purchase of asset	Asset A/c…………………. Dr To Hire Vendor A/c (With Full Cash Price)	Hire Purchaser A/c……. Dr To Sales a/c
6. For the payment made for 'Down Payment'	Hire Vendor A/c…………...Dr To Bank A/c	Bank A/c……………. Dr To Hire Purchaser A/c
7. For installment due	Interest A/c………………. Dr To Hire Vendor A/c	Hire Purchaser A/c……Dr To Interest A/c
8. For the payment of installment	Hire Vendor A/c…………...Dr To Bank A/c	Bank A/c……………. Dr To Hire Purchaser A/c
9. For charging depreciation (on the basis of cash value)	Depreciation A/c…………. Dr To Asset A/c	Note: Depreciation will not charge by hire vendor. No Entry
10. For transfer of interest and depreciation	Profit and Loss A/c………Dr To Interest A/c To Depreciation A/c	Interest A/c………… Dr To Profit and Loss A/c

Note: Entries 3,4,5 And 6 Will Be Repeated Year After Year Until the Final Installment Is Paid.

Second Method (Actual Cash Price Method):

Nature of Transaction	**In the books of Hire Purchaser**	**In the books of Hire Vendor**
1. At the time of agreement	Asset A/c ………………. Dr To Hire Vendor A/c	Hire Purchaser A/c……. Dr To Sales a/c
2. For the payment made for 'Down Payment'	Hire Vendor A/c…………...Dr To Bank A/c	Bank A/c……………. Dr To Hire Purchaser A/c
3. For installment due	Asset A/c………………. Dr Interest A/c……………. Dr To Hire Vendor A/c	Hire Purchaser A/c……Dr To Interest A/c To Sales A/c (Cash Price)
4. For the payment of installment	Hire Vendor A/c…………...Dr To Bank A/c	Bank A/c……………. Dr To Hire Purchaser A/c
5. For charging depreciation (on the basis of cash value)	Depreciation A/c…………. Dr To Asset A/c	Note: Depreciation will not charge by hire vendor. No Entry
6. For transfer of interest and depreciation	Profit and Loss A/c………Dr To Interest A/c To Depreciation A/c	Interest A/c………… Dr To Profit and Loss A/c

Note: Entries 3,4,5 And 6 Will Be Repeated Year After Year Until the Final Installment Is Paid.

Illustration 1: Krishna Purchased a Motor Car (Hire Purchase Basis) on January 1, 2018 from Rama.

The Cash Price ₹ 112,000.

Down Payment ₹ 30,000. (Being Paid on Signing the Agreement)

Three Installments (Each Installment ₹ 30,000 each)

Interest Rate 5% (p.a.)

Depreciation 20% (p.a.) on Reducing Balance Method.

Write Journal Entries in the Books of Hire Purchaser and Hire Vendor.

Solution:

Working Notes:

Hire Purchase Price = Down Payment + Three Installments

= 30,000 + (30,000+30,000+30,000)

= 120,000.

Total Interest = Hire Purchase Price – Cash Price

= 120,000 - 112,000

= 8,000.

<u>Calculation of Interest in Each Installment</u>

		Interest	Cash Price	Installment Price	Installment
Cash Price	112,000				
Down Payment	30,000				
Cash Price at the time of 1st Installment	82,000	4,100	25,900	30,000	I
	25,900				
Cash Price at the time of 2nd Installment	56,100	2,805	27,195	30,000	II
		1,095	28,905	30,000	III
		8,000	82,000	90,000	

First Method: (Full Cash Price Method)

Journal Entries in the Books of Krishna (Hire Purchaser)

Date	Particulars		Debit ₹	Credit ₹
01.01.2018	Motor Car A/c	Dr	112,000	
	To Rama A/c			112,000
	(Being Motor Car Purchased on Hire Purchase Basis)			
01.01.2018	Rama A/c	Dr	30,000	
	To Bank A/c			30,000
	(Being Down Payment done.)			
31.12.2018	Interest A/c	Dr	4,100	
	To Rama A/c			4,100
	(Being 1st Installment Interest to be Paid)			
31.12.2018	Rama A/c	Dr	30,000	
	To Bank A/c			30,000
	(Being 1st Installment with Interest Paid)			
31.12.2018	Depreciation A/c	Dr	22,400	
	To Motor Car			22,400
	(Being Depreciation on Car Charged)			
31.12.2018	Profit and Loss A/c	Dr	26,500	
	To Interest A/c			4,100
	To Depreciation A/c			22,400
	(Being Depreciation and Interest transferred to P & L A/c.)			
31.12.2019	Interest A/c	Dr	2,805	
	To Rama A/c			2,805
	(Being 2nd Installment Interest to be Paid)			
31.12.2019	Rama A/c	Dr	30,000	
	To Bank A/c			30,000
	(Being 2nd Installment with Interest Paid)			
31.12.2019	Depreciation A/c	Dr	17,920	
	To Motor Car			17,920
	(Being Depreciation on Car Charged)			
31.12.2019	Profit and Loss A/c	Dr	20,725	
	To Interest A/c			2,805
	To Depreciation A/c			17,920
	(Being Depreciation and Interest transferred to P & L A/c.)			
31.12.2020	Interest A/c	Dr	1,095	
	To Rama A/c			1,095
	(Being last Installment Interest to be Paid)			
31.12.2020	Rama A/c	Dr	30,000	
	To Bank A/c			30,000

	(Being last Installment with Interest Paid)		
31.12.2020	Depreciation A/c Dr	14,336	
	To Motor Car		14,336
	(Being Depreciation on Car Charged)		
31.12.2020	Profit and Loss A/c Dr	15,431	
	To Interest A/c		1,095
	To Depreciation A/c		14,336
	(Being Depreciation and Interest transferred to P & L A/c.)		

Depreciation Working:

Motor Car Price	112,000
Less: Depreciation	22,400
2nd yr. Car Value	89,600
Less: Depreciation	17920
3rd yr. Car Value	71,680
Less: Depreciation	14336
	57,344

Journal Entries in the Books of Rama (Hire Vendor)

Date	Particulars	Debit ₹	Credit ₹
01.01.2018	Krishna A/c Dr	112,000	
	To Hire Sales A/c		112,000
	(Being goods sold on Hire Purchase Basis)		
01.01.2018	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being Down Payment Received)		
31.12.2018	Krishna A/c Dr	4,100	
	To Interest A/c		4,100
	(Being Interest Amount Due on 1st Installment)		
31.12.2018	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being 1st Installment Amount With Interest Received)		
31.12.2018	Interest A/c Dr	4,100	
	To Profit and Loss A/c		4,100
	(Being Interest transferred to P & L A/c)		
31.12.2019	Krishna A/c Dr	2,805	
	To Interest A/c		2,805

	(Being Interest Amount Due on 2nd Installment)		
31.12.2019	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being 2nd Installment Amount With Interest Received)		
31.12.2019	Interest A/c Dr	2,805	
	To Profit and Loss A/c		2,805
	(Being Interest transferred to P & L A/c)		
31.12.2020	Krishna A/c Dr	1,095	
	To Interest A/c		1,095
	(Being Interest Amount Due on Last Installment)		
31.12.2020	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being 2nd Installment Amount With Interest Received)		
31.12.2020	Interest A/c Dr	1,095	
	To Profit and Loss A/c		1,095
	(Being Interest transferred to P & L A/c)		

Second Method: (Actual Cash Price Method)

Journal Entries in the Books of Krishna

Date	Particulars	Debit ₹	Credit ₹
01.01.2018	Motor Car A/c Dr	30,000	
	To Rama A/c		30,000
	(Being Motor Car purchased on Hire Purchase Basis and down payment to be paid)		
01.01.2018	Rama A/c Dr	30,000	
	To Bank A/c		30,000
	(Being Down Payment done.)		
31.12.2018	Motor Car A/c Dr	25,900	
	Interest A/c Dr	4,100	
	To Rama A/c		30,000
	(Being 1st Installment with Interest to be Paid)		
31.12.2018	Rama A/c Dr	30,000	
	To Bank A/c		30,000
	(Being 1st Installment with Interest Paid)		
31.12.2018	Depreciation A/c Dr	22,400	
	To Motor Car		22,400
	(Being Depreciation on Car Charged)		
31.12.2018	Profit and Loss A/c Dr	26,500	
	To Interest A/c		4,100
	To Depreciation A/c		22,400

	(Being Depreciation and Interest transferred to P & L A/c.)		
31.12.2019	Motor Car A/c Dr	27,195	
	Interest A/c Dr	2,805	
	To Rama A/c		30,000
	(Being 2nd Installment with Interest to be Paid)		
31.12.2019	Rama A/c Dr	30,000	
	To Bank A/c		30,000
	(Being 2nd Installment with Interest Paid)		
31.12.2019	Depreciation A/c Dr	17,920	
	To Motor Car		17,920
	(Being Depreciation on Car Charged)		
31.12.2019	Profit and Loss A/c Dr	20,725	
	To Interest A/c		2,805
	To Depreciation A/c		17,920
	(Being Depreciation and Interest transferred to P & L A/c.)		
31.12.2020	Motor Car A/c Dr	28,905	
	Interest A/c Dr	1,095	
	To Rama A/c		30,000
	(Being last Installment with Interest to be Paid)		
31.12.2020	Rama A/c Dr	30,000	
	To Bank A/c		30,000
	(Being last Installment with Interest Paid)		
31.12.2020	Depreciation A/c Dr	14,336	
	To Motor Car		14,336
	(Being Depreciation on Car Charged)		
31.12.2020	Profit and Loss A/c Dr	15,431	
	To Interest A/c		1,095
	To Depreciation A/c		14,336
	(Being Depreciation and Interest transferred to P & L A/c.)		

Journal Entries in the Books of Rama

Date	Particulars	Debit ₹	Credit ₹
01.01.2018	Krishna A/c Dr	30,000	
	To Hire Sales A/c		30,000
	(Being goods sold on hire purchase basis and down payment due)		
01.01.2018	Bank A/c Dr	30,000	
	To Krishna A/c		30,000

	(Being Down Payment Received)		
31.12.2018	Krishna A/c Dr	30,000	
	To Hire Sales A/c		25,900
	To Interest A/c		4,100
	(Being 1st Installment amount with Interest Due)		
31.12.2018	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being 1st Installment Amount Received)		
31.12.2018	Interest A/c Dr	4,100	
	To Profit and Loss A/c		4,100
	(Being Interest transferred to P & L A/c)		
31.12.2019	Krishna A/c Dr	30,000	
	To Hire Sales A/c		27,195
	To Interest A/c		2,805
	(Being 2nd Installment Amount with interest Due)		
31.12.2019	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being 2nd Installment Amount Received)		
31.12.2019	Interest A/c Dr	2,805	
	To Profit and Loss A/c		2,805
	(Being Interest transferred to P & L A/c)		
31.12.2020	Krishna A/c Dr	30,000	
	To Hire Sales A/c		28,905
	To Interest A/c		1,095
	(Being Last Installment Amount with Interest Due)		
31.12.2020	Bank A/c Dr	30,000	
	To Krishna A/c		30,000
	(Being last Installment Amount Received)		
31.12.2020	Interest A/c Dr	1,095	
	To Profit and Loss A/c		1,095
	(Being Interest transferred to P & L A/c)		

1.5. Calculation of Interest and Cash Price in Various Contexts: Hire purchase problems require periodic computation of interest under any of the following cases:

i) When Rate of Interest, Cash Price and Hire Purchase Price are Given: When cash price, rate of interest etc. are given, interest is calculated on the total cash price remaining unpaid at the time of paying the installment. While calculating interest for the last installment, the difference between the installment payable and the unpaid cash price is taken to be the interest, interest on unpaid price is not to be calculated. The calculations are explained with the help of an example.

Illustration 2: From the following particulars, calculate interest in each installment.

Cash Price ₹ 17,430

Rate of Interest is 10%

Down Payment is ₹ 5,000.

Three Installments, each installment is ₹ 5,000.

Solution:

		Interest	Cash Price	Installment Price	Installment
Cash Price	17,430				
Down Payment	5,000				
Cash Price at the time of 1st Installment	12,430	1243	3,757	5,000	I
	3,757				
Cash Price at the time of 2nd Installment	8,673	867	4,133	5,000	II
		460	4,540	5,000	III
		2,570	12,430	15,000	

ii) When Rate of Interest is not Given: When rate of interest is not given, total interest payable will be divided in the ratio of outstanding balance of hire purchase price. This is explained with the following Example:

Illustration 3: Calculate interest in each installment.

Cash Price ₹ 30,000

Down Payment ₹ 6,000.

Three Equal Installments ₹ 10,000 each.

Solution:

Cash Price	30,000

Less: Down Payment	6,000
Cash Price paid in Installments	24,000

Total Payment = Down Payment + Three Installments

= 6,000 + 10,000 + 10,000 + 10,000

= 36,000.

∴ Total Interest = Hire Purchase Price – Cash Price

= 36,000 – 30,000

= 6,000.

Note: The above interest amount to be divided in the ratio of amount outstanding before paying each installment.

Amount outstanding before paying first installment = ₹ 30,000.

Amount outstanding before paying first installment = ₹ 20,000.

Amount outstanding before paying first installment = ₹ 10,000.

∴ 30,000: 20,000: 10,000

3: 2: 1

Interest for First Year $= \frac{3}{6} \times 6{,}000 = 3{,}000.$

Interest for Second Year $= \frac{2}{6} \times 6{,}000 = 2{,}000.$

Interest of Third Year $= \frac{1}{6} \times 6{,}000 = 1{,}000.$

iii) When Cash Price is not Given: In some cases, cash price is not given. Since the asset purchased cannot be capitalized at hire purchase price (or installment purchase price). It is necessary to start with the last installment and deduct interest form it. Interest is calculated as follows.

$$= \frac{\text{Rate of Interest}}{100 + \text{Rate of Interest}} \times \text{Amount Due}$$

Illustration 4: Calculate the cash price and interest included in each installment.

Rate of Interest 10%. 8,302

Down Payment ₹ 5,000.

Four Equal Installments ₹ 10,000 each.

Solution:

	₹
Amount Due before 4th Installment	10,000
Less: Interest $= \frac{10}{110} \times 10{,}000$	909
	9,091
Add: 3rd Installment	10,000
	19,091
Less: Interest $= \frac{10}{110} \times 19{,}091$	1,736
	17,355
Add: 2nd Installment	10,000
	27,355
Less: Interest $= \frac{10}{110} \times 27{,}355$	2,487
	24,868
Add: 1st Installment	10,000
	34,868
Less: Interest $= \frac{10}{110} \times 34{,}868$	3,170
	31,698
Add: Down Payment	5,000
Total Cash Price	36,698

Short Answer Questions (2 Marks)

1. What is Hire Purchase System?
2. What is Hire Charges?
3. How Many Parties in Hire Purchase Agreement? What are they?

Essay Answer Questions (6 Marks)

1. What are the differences between Hire Purchase System and Installment Purchase System?

Exercises

1. Calculate The Amount of Interest Include in The Three Installments in Hire Purchase, Given the Following Information:
   Cash Price of the asset is ₹ 14,900; Interest is at 5% p.a. Payments made were:

2019 January 1	Down Payment	₹ 4,000.
2019 December 31	1st Installment	₹ 4,000.
2020 December 31	2nd Installment	₹ 4,000.
2021 December 31	3rd Installment	₹ 4,000.

   (Ans: Interest 2019 - ₹ 545; 2020 - ₹ 372; 2021 – 183.)

2. Ramu purchased asset on hire purchase system. Ascertain the amount of interest included in three installments on the basis of the following information.

Cash Price of the Asset	₹ 11,175.
Initial Payment	₹ 3,000.
Three Equal Installments	₹ 3,000 each.
Rate of Interest	5%.

   (Ans: Interest 1st Yr. ₹ 545; 2nd Yr. ₹ 372; 3rd Yr. ₹ 183.)

3. Mohan purchased asset on hire purchase system.

The total cash price of the motor cycle is	₹ 15,980.
Down Payment	₹ 4,000.
1st Installment	₹ 6,000.
2nd Installment	₹ 5,000.
3rd Installment	₹ 2,000.
Rate of Interest	5% p.a.

   You are calculating the interest paid by Sriram to the seller each year.
   (Ans: Interest 1st Yr. ₹ 599; 2nd Yr. ₹ 329; 3rd Yr. ₹ 92.)

4. Muneer purchased machinery under hire purchased system from Salman. The cash price of the machinery was ₹ 15,000. The payment for the purchase is to be made as under:

On signing the agreement	₹ 3,000.

First Year Ending	₹ 5,000.
Second Year Ending	₹ 5,000.
Third Year Ending	₹ 5,000.

Calculate the interest included in each installment.

(Ans: Interest 1st Yr. ₹ 1,500; 2nd Yr. ₹ 1,000; 3rd Yr. ₹ 500.)

5. On the basis of the following information, ascertain the interest included in each installment.

Cash Price of the Asset	₹ 9,000.
Initial Payment	₹ 3,000.
Three Equal Installments	₹ 3,000 each.

(Ans: Interest 1st Yr. ₹ 1,500; 2nd Yr. ₹ 1,000; 3rd Yr. ₹ 500.)

6. A machine cash price is ₹ 1,800 is sold on hire purchase basis. ₹ 2,000 payable in four quarterly installment of ₹ 500 each. The first installment is paid at the end of the first quarter. Show the amount of interest included in each installment.

(Ans: Interest 1st Yr. ₹ 80; 2nd Yr. ₹ 60; 3rd Yr. ₹ 40; 4th Yr. ₹ 20.)

7. An asset is purchased on hire purchase system. The term of payment are as follows:

₹ 2,000 to be paid on signing the agreement.

₹ 2,800 at the end of the First Year.

₹ 2,600 at the end of the Second Year.

₹ 2,400 at the end of the Third Year.

₹ 2,200 at the end of the Fourth Year.

Interest is charged at the rate of 10% p.a.

Calculate the Cash Price of the Asset.

(Ans: Cash Price ₹ 10,000; Interest 1st Yr. ₹ 800; 2nd Yr. ₹ 600; 3rd Yr. ₹ 400; 4th Yr. ₹ 200.)

8. Ram Prasad Purchased an asset on hire purchase system. Payment was to be made as under:

On signing the agreement	₹ 20,000 to be paid
At the end of the First Year	₹ 15,000.
At the end of the Second Year	₹ 15,000.
At the end of the Third Year	₹ 10,000.

Interest is charged at the rate of 10% p.a.

Determine the Cash Price of the Asset. **(Ans: Cash Price ₹ 53,546.)**

9. On 01.01.2018 K & Sons purchased a Machine on hire purchase system. ₹ 6,000 payable on delivery and three annual installments of ₹ 6,400; ₹ 8,900 and ₹ 8,800. The vendor A & Co. charged interest at 10% p.a. Calculate Cash Price of the Machine. **(Ans: Cash Price ₹ 25,785.)**

10. The payment schedule of a colour TV purchased on hire purchase system is as follows:

₹ 4,400 to be paid on signing the agreement.

₹ 6,160 at the end of the First Year.

₹ 5,720 at the end of the Second Year.

₹ 5,280 at the end of the Third Year.

₹ 4,840 at the end of the Fourth Year.

Interest is charged at the rate of 10% p.a.

Calculate the Cash Price of the TV. **(Ans: Cash Price ₹ 22,000.)**

11. On 1st January, 2018, the company sold an Auto Rickshaw on hire purchase system for ₹ 20,000 to be paid as follows:

On signing the agreement	₹ 2,400 to be paid
At the end of the First Year	₹ 3,200.
At the end of the Second Year	₹ 11,000.

Interest included in ₹ 20,000 being charged on the cash value at 10% p.a. Ascertain the Cash Price of the Auto Rikshaw. **(Ans: Cash Price ₹ 16,400.)**

12. The Vijayawada Transport Company purchased motor car from the Tata Motor Co. on hire purchase agreement on 1st January, 2018. Paying cash ₹ 10,000 as down payment and agreeing to pay further three installments of ₹ 10,000 each on 31st December each year. The cash price of the car is ₹ 37,250 and the Tata Motor Company charges interest at 5% p.a. the Vijayawada Transport Company writes off 10% p.a. as depreciation on the reducing installment system.

Journalize the transactions in the books of Vijayawada Transport Company.

(Ans: Interest 2018 - ₹ 1,363; 2019 - ₹ 931; 2020 - ₹ 456.)

13. On 1st January, 2017 Messrs Ram & Co. bought Van on hire purchase basis from Mahindra Co. ₹ 2,000 being paid on delivery and the remaining balance to be paid in five equal installments ₹ 3,000 each. Mahindra Co. charges 5% interest p.a. The Cash Price of the Van is ₹ 15,000. 10% depreciation to be provided on reducing balance method.

    Journalize the transactions in the books of Messrs Ram & Co.

    (Ans: Interest 2017 - ₹ 650; 2018 - ₹ 533; 2019 - ₹ 456; 2020 - ₹ 280; 2021 - ₹ 128.)

14. Anand purchased a bike from Varun Enterprises on hire purchase system on 1st January, 2018. The first installment was paid immediately and the remaining balance to be paid by four equal installments of ₹ 6,000 each. Varun Enterprises to be charged 5% interest per annum on unpaid balance. The cash price of the bike is ₹ 27,300. Depreciation is charged at 10% on the diminishing balance method.

    Write journal entries in the books of both parties.

    (Ans: Interest 2018 - ₹ 1,065; 2019 - ₹ 818; 2020 - ₹ 559; 2021 - ₹ 258.)

15. Yamini purchased a Machine on hire purchase system. The cash price is ₹ 14,600. ₹ 11,400 were paid at the time of contract on 1st July 2018 and the balance was to be paid by half – yearly installment of ₹ 800. Interest 5% p.a. 10% Depreciation charged on diminishing balance method. Accounts were closed on 30th June.

    Write journal Entries.

    (Ans: Interest ₹ 80; ₹ 60; ₹ 40; ₹ 20.)

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UNIT – III

BANK ACCOUNTS

Introduction– Proforma of Profit and Loss Account and Balance Sheet as per Banking Regulation Act - Books and Registers to be maintained by banks-non-performing assets -–Preparation of bank final Accounts – Exercises.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand about Proforma of Profit and Loss Account
- ☞ Understand about the Balance Sheet

1. Introduction: In India, banking companies are governed by the Banking Regulation Act 1949. Section 5 of the Act defines banking as "the accepting, for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, and order or otherwise "

1.1. Business of Banking Companies: In addition to the business of banking, a banking company may engage in any one or more of the following businesses:

i) The borrowing, raising, or taking up of money

ii) The lending or advancing of money either upon or without security

iii) The drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not.

iv) The granting and issuing of letter of credit, travellers' cheques and circular notes

v) On receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise.

vi) The buying, selling and dealing in bullion

vii) The collecting and transmitting of money and securities

viii) Contracting for public and private loans and negotiating and issuing the same

ix) Carrying on and transacting every kind of guarantees and indemnity business

x) Undertaking and executing trusts, etc.

1.2. Important Provisions of the Banking Regulation Act 1949:

i) Statutory Reserve: As per Section 17, banking companies incorporated in India hall transfer every year at least 25% of its profit before any dividend is declared to a Statutory reserve (Reserve fund) until the amount of the reserve together with the security premium Account is equal to the paid-up capital.

ii) Cash Reserve Ratio (CRR): Banks are required to maintain with the Reserve Bank of India a cash reserve of at least 3% of the total of its demand and time liabilities in India.

iii) Statutory Liquidity Ratio (SLR): Banks are also required to maintain atleas6t 25% of the demand and time liabilities in the form of liquid assets like cash, gold or unencumbered. SLR may vary in a range of 25% to 40%.

iv) Non – Banking Assets: These are the assets which are not used in the ordinary course of business of banking, but they are such immovable and movable properties which come under the possession of the banking company for recovering the amount due from customers.

v) Minimum Capital and Reserves: In case of a banking company incorporated in India, the sum of its paid-up capital and reserves shall not be less than the amount mentioned below:

- If it has places of business in more than one state Rs.500000, and if any such place of business is situated in Mumbai or Kolkata or in both, Rs.1000000.
- If it has all its places of business in one state, none of which is Mumbai or Kolkata, Rs.100000 in respect of its principal place of business plus Rs.10000 for each additional place of business in the same district plus Rs.25000 for each place of business elsewhere in the state (the maximum amount required being Rs.500000).

1.3. Accounting System: The accounting system of a banking company is different from that of a trading or manufacturing company. The main features of a bank's accounting system are as follows:

i) Entries in the personal ledgers are made directly from the vouchers
ii) From such entries in the personal ledgers each day summary sheets in total are prepared which are posted to the control accounts in the general ledger.
iii) The general ledger's trial balance is extracted and agreed every day.
iv) All entries in the personal ledgers and summary sheets are checked by persons other than those who have recorded entries. It helps in detection of mistakes.
v) A trial balance of detailed personal ledgers is prepared periodically and gets agreed with the general ledger control accounts.
vi) Two vouchers are prepared for every transaction not involving cash.

1.4. Books Maintained by Banks:

i) Receiving Cashier's Counter Cash Book.
ii) Paying Cashier's Counter Cash Book.
iii) Current Accounts Ledger.
iv) Saving Bank Accounts Ledger.
v) Fixed Deposit Accounts Ledger.
vi) Investment ledger.
vii) Bills Discounted and Purchased Ledger.
viii) Loan Ledger.
ix) Cash Credit Ledger.
x) Customers' Acceptances, endorsements and Guarantee Ledger.
xi) Recurring Deposits Accounts Ledger, etc.

1.5. The Slip System: This is not a system of book keeping, but a method of rapidly posting entries to books kept on double entry system. In this system, posting is made from slips prepared inside the organization itself or from slips filled in by its customers. In a banking company, the main slips are pay-in-slips, withdrawal slips and cheques and all these slips are filled in by clients of the bank.

Advantages of Slip system:

a. It makes accounts reliable.
b. Slips are the basis of auditing.
c. The bank saves a lot of clerical labour as most of the slips are filled in by its customers.
d. There is no need for keeping subsidiary books.

Disadvantages of Slip system:

a) Slips may be lost, destroyed or misappropriated as these are loose.
b) In the absence of subsidiary books, books cannot be verified.
c) It is very difficult and expensive to keep date wise record of a large number of slips.
d) Customers feel difficulty on account of slip system.

1.6. Final Accounts of Banks: As per Section 29, a banking company incorporated in India, is required to prepare, at the end of each accounting year, a Balance sheet and profit and Loss Account as on the last working day of the year.

Profit and Loss Account: A banking company is required to prepare its Profit and Loss Account according to Form B in the Third Schedule to the Banking Regulation Act, 1949. Form B is given as follows:

Form B

Form of Profit & Loss Account for the year ended 31st March

Particulars	Schedule	Current Year	Previous Year
I. Income:			
Interest Earned	13	XXX	XXX
Other Income	14	XXX	XXX
Total		XXX	XXX
II. Expenditure:			
Interest	15	XXX	XXX
Operating Expenses,			
Provisions & Contingencies	16	XXX	XXX
Total		XXX	XXX

III. Profit / Loss:			
Net Profit / Net Loss (I – II)		XXX	XXX
IV. Appropriations:			
Transfer to Statutory Reserves		XXX	XXX
Transfer to Other Reserves		XXX	XXX
Transfer to Proposed Dividend		XXX	XXX
		XXX	XXX

Schedule 13 – Interest Earned

Particulars	**Current Year**	**Previous Year**
I. Interest/ discount on advances/bills	XXX	XXX
II. Income on investments	XXX	XXX
III. Interest on balances with Reserve Bank of India and other inter-bank funds	XXX	XXX
IV. Others	XXX	XXX
Total	XXX	XXX

Schedule 14 – Other Income

Particulars	**₹**	**Current Year**	**Previous Year**
1.Commission, exchange and brokerage		XXX	XXX
2.Profit on sale of investments	XXX		
Less: Loss on sale of investments	XX	XXX	XXX
3. Profit on revaluation of investments	XXX		
Less: Loss on revaluation of investments	XX	XXX	XXX
4. Profit on sale of land, buildings and other assets	XXX		
Less: Loss on sale of land, buildings and other Assets	XX	XXX	XXX
5. Profit on exchange transactions	XXX		
Less: Loss on exchange transactions	XX	XXX	XXX
6. Income earned by way of dividends etc. from subsidiaries/ companies and/or joint ventures			

abroad/in India		XXX	XXX
7. Miscellaneous income		XXX	XXX
Total		XXX	XXX

Schedule 15 – Interest Expended

Particulars	**Current Year**	**Previous Year**
I. Interest on deposits	XXX	XXX
II. Interest on Reserve Bank of India/		
inter- bank borrowings	XXX	XXX
III. Others	XXX	XXX
Total	XXX	XXX

Schedule 16– Operating Expenses

Particulars	**Current Year**	**Previous Year**
I. Payments to and provisions for employees	XXX	XXX
II. Rent, taxes and lighting	XXX	XXX
III. Printing and stationary	XXX	XXX
IV. Advertisement and publicity	XXX	XXX
V. Depreciation on bank's property	XXX	XXX
VI. Directors' fees, allowances and expenses	XXX	XXX
VII. Auditor's fees, allowances and expenses		
(Including branch auditors)	XXX	XXX
VIII. Law charges	XXX	XXX
IX. Postages, telegrams, telephones, etc.	XXX	XXX
X. Repairs and maintenance	XXX	XXX
XI. Insurance	XXX	XXX
XII. Other expenditure	XXX	XXX
Total	XXX	XXX

Illustration 1: Following figures have been obtained from the books of Rai Bank Ltd for the year ending 31st March 2021. Issued and subscribed capital Rs.100,000, Interest

and discount earned Rs.3800, Commission and exchange earned Rs.1,950, Interest paid Rs.2000, Salaries and wages Rs.2,100, Directors fees Rs.350, Rent and taxes Rs.700, Postage and telegrams Rs.610, Profit on sale of investments Rs.2400, Loss on sale of investments Rs.380, Rent received Rs. 620, Depreciation Rs.310, Stationary Rs.600 and Auditors fees Rs.800.

Additional information:

a. The profit and loss account had a balance of Rs.10,00,000 on 1st April 2010.
b. An advance of Rs.12,00,000 has become doubtful and it is expected that only 50% of the amount due can be recovered from the security.
c. The provision of tax is made at 50%.
d. A dividend of 10% is proposed.

Prepare Profit and Loss Account of Rai Bank Ltd for the year ending 31st March 2021.

Profit and Loss Account of VC Bank Ltd

(For the year ended 31st March 2021)

Particulars	Schedule	31.03.21
I. Income:		
Interest Earned	13	3,800
Other Income	14	4,590
Total		8,390
II. Expenditure:		
Interest	15	2,000
Operating Expenses		4,750
Provisions & Contingencies	16	1,192
Total		7,942
III. Profit / Loss:		
Net Profit / Net Loss (I – II)		448
Profit b/f (last year balance)		1,000
Total		1,448
IV. Appropriations:		
Transfer to Statutory Reserves		112
Transfer to Other Reserves		100
Transfer to Proposed Dividend		500
Balance c/d to Balance Sheet		736
Total		1,448

Illustration 2: From the following information, prepare the Profit and loss Account of the National Bank for the year ended 31st March 2021(figures in ‘000):

Interest on loans Rs.518, Interest on cash credits Rs.446, Discount on bills discounted (net) Rs.390, Interest on Overdrafts Rs.108, Interest on Savings bank Account Rs.220, Interest on fixed deposits Rs.554, Commission, exchange and brokerage Rs.16.40, Rent, taxes and lighting Rs.36, Auditors fees Rs.2.40, Postage, telegrams and telephones Rs.2.80, Sundry charges Rs.2, Directors fees Rs.6, Printing and stationery Rs.0.40, Law charges Rs.1.40, payment to employees Rs.108, Locker rent Rs.0.70, Transfer fees Rs.1.40, Depreciation on bank’s property Rs.10 and Advertisement an publicity Rs.1.40.

Additional information: Rebate on bills discounted Rs.98000 and provide for bad debts Rs.58000.

Solution:

VC Bank Ltd

Profit and Loss Account

For the year ended 31st March 2021

Particulars	**Schedule**	**31.03.21**
I. Income:		
Interest Earned	13	1,500
Other Income	14	1,200
Total		2,700
II. Expenditure:		
Interest	15	900
Operating Expenses		650
Provisions & Contingencies	16	400
Total		1,950
III. Profit / Loss:		
Net Profit / Net Loss (I – II)		750
Profit b/f (last year balance)		600
Total		1,350

IV. Appropriations:		
Transfer to Statutory Reserves		150
Transfer to Other Reserves		200
Transfer to Proposed Dividend		300
Balance c/d to Balance Sheet		700
Total		1,350

Contingent Liabilities: A contingent liability is a liability that may or may not happen. This means there is uncertainty about recording such a liability in the financial accounts. This is because the happening or not happening of a contingent liability is not in the hand of us. Contingent liabilities are never recorded in the financial statements of a company. These obligations have not occurred yet but there is a possibility of them occurring in the future. So, a contingent liability has no accounting treatment as such.

1.7. The balance sheet of a banking company is prepared according to Form A in Third Schedule which is as follows:

BALANCE SHEET

Balance Sheet Of …… (Here enter name of the banking company)

as on 31st March (Year)

Particulars	Schedule	Current Year	Previous Year
Capital and Liabilities			
Capital	1	XXX	XXX
Reserves & Surplus	2	XXX	XXX
Deposits	3	XXX	XXX
Barrowings	4	XXX	XXX
Other Liabilities & Provisions	5	XXX	XXX
Total		XXX	XXX
Assets			
Cash and balances with RBI	6	XXX	XXX
Balances with banks	7		
money at call and short notice		XXX	XXX
Investments	8	XXX	XXX

Advances	9	XXX	XXX
Fixed Assets	10	XXX	XXX
Other Assets	11	XXX	XXX
Total		XXX	XXX
Contingent liabilities	12	XXX	XXX
Bills for collection		XXX	XXX

Explanation Of Some Items Relating to Balance Sheet:

i) **Money at Call and Short Notice:** It represents temporary loans to bill brokers, stock brokers and other banks. If the loan is given for one day, it is called "money at call" and if the loan cannot be called back on demand and will require at least a notice of three days for calling back, it is called "money at short notice".

ii) **Advances:** Advances include Bills discounted and purchased, loans, cash credit and overdraft.

iii) **Inter - Office Adjustments:** Every head office will have a number of transactions with its branches. The head office makes necessary adjustments in its books on the receipt of information from the branches. On the date of balance sheet some transaction may remain unadjusted in the books of the head office. Such entries are recorded in the balance sheet under the sub-heading 'Branch Adjustments' and may appear on the assets side under the heading 'Other Assets' if it has a debit balance and on t e liabilities side under the heading 'Other Liabilities' if it has a credit balance.

iv) **Bills for Collection:** When the bank receives bills receivables from its customers for collection, it keeps them till maturity. On the date of maturity when bills are collected, customers account is credited with the amount collected. If some bills remain outstanding, such bills are treated by the banks as outstanding bills for collection. It is shown as 'Contingent Liability (Schedule 12)'.

v) **Acceptance, Endorsement and Other Obligation:** This represents bank's liability on account of bills endorsed or accepted on behalf of its customers. For greater security, the drawer of bill wants acceptance of the drawee's bank. The bank incurs a liability by accepting bills on behalf of customers. On the maturity of bill, the bank pays and collects the amount from its customers. At the end of the accounting period, if tee is any outstanding bills it is shown on the 'Contingent Liability (Schedule 12)'.

1.8. Non-Performing Assets (NPA): Bank advances can be classified as Performing Assets and Non-Performing Assets (NPA). An asset becomes NPA when it ceases to generate income for the bank. NPA means a credit facility in respect of which interest and/or principal repayment installments is in arrears for more than 90 days. Interest income from NPA is considered as income as and when it is received rather than on accrual basis.

Asset Classification: Bank's loans and advances are to be classified into two broad categories- Standard assets and Non-Performing Assets. NPAs are subdivided into three- Substandard, Doubtful and Loss Assets. These may be explained as follows:

1. Standard Assets – Standard assets are those which do not carry more than the normal credit risk attached to the business. These are assets which are not NPAs.

2. Sub-standard Assets – These have been classified as NPA for a period not exceeding 12 months.

3. Doubtful Assets - Doubtful Assets are those which have remained NPA for a period exceeding 12 months.

4. Loss Assets – Loss assets are those assets in which loss has been identified by the bank, auditors or RBI but the amount has not been written off wholly or partly. These assets are irrecoverable.

Short Answer Questions (2 Marks)

1. What is CRR?
2. What is SLR?
3. What is Contingent Liability?
4. What are the books maintained by Banks?
5. What is Slip System?

Essay Answer Questions (6 Marks)

1. What are the differences between Hire Purchase System and Installment Purchase System?

Exercises

1. Prepare Profit and Loss Account of Anand Bank Ltd for the year ended 31st March, 2021 from the following particulars:

Particulars	₹	Particulars	₹
interest on deposits	30,00,000	salaries and allowances	8,00,000
discount	15,00,000	bad debts	3,00,000
interest on overdraft	10,00,000	director's fees	20,000
interest on cash credit	5,00,000	auditors' fees	80,000
commission	2,00,000	provision for income tax	1,00,000
interest on loans	35,00,000	depreciation on assets	2,00,000
rent and taxes	2,00,000	dividends	3,00,000

(Ans: Current Year Profit ₹ 20,90,000.)

2. From the following details relating to the M Bank Ltd. Find out the net profit earned by the bank in the year ending with 31st March, 2022.

Particulars	₹
Interest earned	5,00,000
Other income	15,000
interest paid	2,35,000
Operating Expenses	64,000
Provisions and Contingencies	75,000
Transferred to Statutory Reserve	20% of Net Profit
Transferred to Proposed dividend	25,000

(Ans: Current Year Net Profit ₹ 141,000.)

3. The following are the balances of Indian Bank Ltd. For the year ended 31.03.2021.

Particulars	₹	Particulars	₹
interest earned:		commission received	16,000
interest on loans	182,360	locker rent received	9,455
discount on bills	12,250	received transfer fees	8,633
interest on cash credits	6,430	**operating expenses:**	
interest on overdrafts	3,336	salaries and allowances	34,550
interest expended:		rent and taxes	11,400
interest on fixed deposits	43,650	Director's fees	10,000
interest on recurring accounts	12,698	postages and telegrams	8,798
interest on savings accounts	29,692	depreciation on properties	33,000
		sundry charges	9,000

From the above information, prepare the Profit and Loss account of the bank.
(Ans: Current Year Net Profit ₹ 35,676.)

4. Prepare New Bank (P) Ltd. Balance Sheet as on 31.3.2022 from the following particulars:

Particulars	₹	Particulars	₹
capital	2,000	letter of credit	2,000
investments	17,000	other assets	6,700
bill endorsement	1,000	receipts on behalf of customers	5,000
telegraphic payments	3,000	short term loans	200
bank drafts	2,000	cash in hand	2,000
money at call short notice	9,000	cash at RBI	3,000
reserves	3,000	cash at other banks	2,000
loans	10,000	current deposits	56,000
bank overdraft	2,000	bills purchased	1,000
premises	15,000	fixed deposits	4,000
bill discount	10,000	liability on discounted bills	4,00,000
profit and loss account	8,500	outstanding forward exchange	2,00,000

(Ans: Balance Sheet Total: ₹ 7,87,00,000.)

5. Prepare Balance Sheet of Vasavi Bank Ltd. As on 31.03.2022 from the following particulars:

Particulars	₹	Particulars	₹
share capital	350,000	cash on hand	109,200
reserve fund	100,250	balance with other banks	200,000
deposits:		cash with RBI	180,000
fixed deposits	265,000	**advances:**	
savings deposits	500,000	bill discounted and	
current deposits	200,000	purchased	100,000
money at call with short notice	100,000	loans, overdrafts and	
investments (at cost)	210,000	cash credits	180,000
profit & loss a/c (cr)	103,950	fixed assets	700,000
barrowings from other banks	145,000	other assets	80,600
other liabilities:		contingent liabilities	140,000
rebate on bills discounted	25,000	bills for collection	25,000
sundry creditors	55,000		
bills payable	25,600		
unclaimed dividends	25,000		
provision for bad debts	15,000		
provision for tax	50,000		

(Ans: Balance Sheet Total: ₹ 18,59,800.)

6. Prepare Balance Sheet of ABC Bank Ltd from the following particulars:

Particulars	**₹ ('000)**	**Particulars**	**₹ ('000)**
share capital	2,000	reserves and surplus (profit)	1,534
fixed assets	2,217	other liabilities and provisions	64
deposits	27165	cash on hand	255
Loans from banks	6,482	investments	9,882
balance with other banks	1,000	bills for collection	1,500
cash with RBI	2,000	money at call with short notice	206
advances	21,685	contingent liabilities	575

(Ans: Balance Sheet Total: ₹ 3,72,45,000.)

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UNIT – IV

DEPRECIATION

Depreciation: Meaning – Causes - Need for depreciation – Causes of depreciation – Methods of depreciation –Straight Line Method and Diminishing Balance Method – Exercises.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand about need, causes of depreciation
- ☞ Understand about the Calculating Methods of Depreciation

1. Introduction: Depreciation" means decline in the value of a fixed assets due to use, passage of time or obsolescence. In other words, if a business enterprise procures a machine and uses it in production process then the value of machine declines with its usage. Even if the machine is not used in production process, we cannot expect it to realise the same sales price due to the passage of time or arrival of a new model (obsolescence). It implies that fixed assets are subject to decline in value and this decline is technically referred to as depreciation.

1.1. Meaning: Depreciation may be described as a permanent, continuing and gradual shrinkage in the book value of fixed assets. It is based on the cost of assets consumed in a business and not on its market value. Depreciation is allocated so as to charge fair proportion of depreciable amount in each accounting period during the expected useful life of the asset.

1.2. Causes for Depreciation:

i) **Wear and tear: The** asset may decrease in its value because of constant use in the business. This is also caused because of erosion. When the asset is exposed to sun, wind or rain it may lose its value.

ii) **Lapse of Time:** Assets may have a fixed life period. After the expiry of its life, the asset may become useless. This may happen in plant and machinery, lease. Copyright patents etc. After the expiry of the fixed life the asset may become useless.

iii) **Accident:** The assets may reduce in value because of the accident. It is not gradual decrease, but there is a permanent loss in its value.

iv) **Inadequacy of Assets:** The increase in the size or growth of the business may cause inadequacy of the asset. As a result, the asset may be terminated.

v) **Obsolescence: When** the asset become outdated, it becomes useless in the business. So, it is to be replaced by new and modern assets with the latest technology. Thus, the old asset losses its value.

vi) **Depletion: Asset** may be exhausted through its working e.g., mines, minerals, oil etc. These assets get exhausted because of extraction and exploitation. Hence the assets become useless.

1.3. Need For Providing Depreciation: The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss for proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.
2. To present a true and fair view of the financial position If the amount of depreciation is not provided on fixed assets in the books of account, the value of fixed assets will be shown at a higher value than its real value in the balance sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.
3. To ascertain the real cost of production for ascertaining the real cost of production, it is necessary to provide depreciation.
4. To comply with legal requirements as per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.
5. To replace assets Depreciation is provided to replace the assets when it becomes useless.

1.4. Factors Influencing Depreciation:

- Wear and tear due to constant use.

- Decrease in the market value of the asset.
- Due to obsolescence i.e., permanent change in the asset may be result in the uselessness of the asset.
- Non-functioning of a machine may cause depreciation.
- Accident and damage of an asset will be caused depreciation.

1.5. Accounting Treatment: Journal Entries

Date	Particulars	Dr. ₹	Cr. ₹
	When the asset is purchased: - Asset Account Dr. To Bank Account (Being the asset purchased)	XXX	XXX
	When the depreciation is provided on the asset: - Depreciation Account Dr. To Asset Account (Being the depreciation calculated)	XXX	XXX
	When the depreciation is transferred to P&L A/c: - Profit & Loss A/c Dr. To Depreciation A/c (Being the depreciation transferred to P&L A/c)	XXX	XXX
	When the asset is sold after its working life: - Bank Account Dr. To Asset Account (Being the asset sold)	XXX	XXX
	Profit earned on sale of Asset transferred to P&L A/c: - Asset Account Dr. To Profit & Loss A/c (Being the profit transferred to P&L A/c)	XXX	XXX
	When loss occurred on the sale of an Asset: - Profit & Loss Account Dr. To Asset Account (Being the loss on sale transferred to P&L A/c)	XXX	XXX

1.5. Methods Of Providing Depreciation: The following are the main methods of providing depreciation.

1. Fixed Instalment Method.
2. Diminishing Balance Method.
3. Depreciation Fund Method.
4. Insurance Policy Method.
5. Revaluation Method.
6. Annuity Method.
7. Depletion Method.
8. Machine Hour Rate Method.
9. Global Method.
10. Sum of Digits Method.

1.5.1. Calculating Depreciation under Fixed Installment Method: This method is also known as "Straight Line" or "Original Cost Methods". Under, this method a fixed percentage of original value of the asset is written off every year. In this method depreciation is charged equally every year throughout the life of the asset. The depreciation charged on the asset is fixed throughout the effective life of the asset. At the end of the working life of the asset, balance in the asset account will be Zero. The amount of depreciation is calculated as follows:

$$\text{Annual Depreciation} = \frac{\text{Cost of the Asset} - \text{Scrap Value}}{\text{Estimated Life of the Asset}}$$

$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Total cost of the Asset}} \times 100$$

Advantages:

1. This method is simple and easy to understand.
2. Calculation if depreciation is very easy. The value of asset can be written down to zero.
3. This method is very suitable to those which have a fixed life e.g., furniture and fixtures, lease etc.

Disadvantages:

1. It is difficult to estimate the life of certain asset with accuracy e.g. machinery.
2. The interest on the amount invested in the purchase of asset is not taken into consideration.
3. In this method, it becomes difficult to calculate the depreciation on additions made during the particular year.
4. The same amount of depreciation is charged every year irrespective of the use of the asset. Thus, it does not take into account the effective utilization of the asset.

Illustration: 1

A company purchased Machinery for Rs.1,00,000. Its installation costs amounted to Rs.10,000. It's estimated life is 5 years and the scrap value is Rs.5,000. Calculate the amount and rate of depreciation.

Solution:

Total cost = Purchase Price + Installation Charges
= Rs.1,00,000 + Rs.10,000
= Rs. 1,10,000

$$\text{Annual Depreciation} = \frac{\text{Cost of the Asset – Scrap Value}}{\text{Estimated Life of the Asset}}$$

$$\text{Annual Depreciation} = \frac{110{,}000 - 5000}{5} = 21000$$

$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Total cost of the Asset}} \times 100$$

If annual depreciation is Rs.21,000 and the cost of the asset is Rs.110,000

$$\text{Rate of Depreciation} = \frac{21{,}000}{110{,}000} \times 100 = 19.09\%$$

Illustration: 2

On 1st January 2018, a firm purchased plant and machinery costing Rs.52,000. It is estimated that its working life is 5 years and at the end of which it will fetch Rs.2,000.

Show Plant and Machinery account for 3 years, if depreciation is charged according to straight line method.

Solution: Annual Depreciation = $\dfrac{\text{Cost of the Asset – Scrap Value}}{\text{Estimated Life of the asset}}$

Annual Depreciation = $\dfrac{52{,}000 - 2{,}000}{5}$ = Rs. 10,000

Dr. Plant and Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.18	To Bank a/c	52,000	31.12.18	By depreciation	10,000
				By Balance C/d	42,000
		52,000			52,000
01.01.19	To Balance B/d	42,000	31.12.19	By depreciation	10,000
				By Balance C/d	32,000
		42,000			42,000
01.01.20	To Balance B/d	32,000	31.12.20	By depreciation	10,000
				By Balance C/d	22,000
		32,000			32,000
01.01.21	To Balance B/d	22,000			

Illustration: 3

A machine was purchased on 1st July 2015 at a cost of Rs.18,000 and Rs.2,000 was spent on its installation. The depreciation was written off at the rate of 10% on its original cost. The books were closed on 31st December every year. Show the machinery account and depreciation account for three years.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank a/c				
01.07.16	(18,000+2,000)	20,000	31.12.16	By depreciation	1,000
				By Balance C/d	19000

		20,000			20,000
01.01.17	To Balance B/d	19,000	31.12.17	By depreciation	2,000
				By Balance C/d	17000
		19,000			19,000
01.01.18	To Balance B/d	17,000	31.12.18	By depreciation	2,000
				By Balance C/d	15000
		17,000			17,000
01.01.19	To Balance B/d	15,000			

Dr. Depreciation A/c Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.16	To Machinery A/c	1,000	31.12.16	By P & L A/c	1,000
		1,000			1,000
31.12.17	To Balance B/d	2,000	31.12.17	By P & L A/c	2,000
		2,000			2,000
31.12.18	To Balance B/d	2,000	31.12.18	By P & L A/c	2,000
		2,000			2,000

Illustration: 4

Jagadish purchased a second-hand machine for Rs.57,000 on 01.05.2018 and spent Rs.3,000 for its repairs. On 31.12.2021 the machine became unsuitable and sold for Rs.40,000. The books were closed on 31st December every year. Prepare machinery account from 2018 to 2021 charging depreciation @ 12% p.a. Under fixed installment method.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.05.18	To Bank a/c	60,000	31.12.18	By depreciation	4,800
	(57000 + 3,000)			By Balance C/d	55,200
		60,000			60,000
01.01.19	To Balance B/d	55,200	31.12.19	By depreciation	7,200

				By Balance C/d	48,000
		55,200			55,200
01.01.20	To Balance B/d	48,000	31.12.20	By depreciation	7,200
				By Balance C/d	40800
		48,000			48,000
01.01.21	To Balance B/d	40,800	31.12.21	By depreciation	7,200
	To P & L A/c				
	(Profit on Sale)	6,400		By Bank A/c	40,000
		47,200			47,200

Calculation of Profit or Loss on The Sale of The Asset:

Cost of the Asset	(57,000 + 3000)	60,00
Less: Total Depreciation (4800+(7200+7200+7200)		26,400
Written down value (W.D.V)		33,600
Less: Sale of machinery on 31.12.2011		40,000
Profit on Sale		6,400

Note: If the sale value is more than the W.D.V. of the asset, it is profit. If the sale value is less than the W.D.V. of the asset, it is loss.

1.5.2. Calculating Depreciation under Diminishing Balance Method: This Method is also known as "Written Down value Method" or "Reducing balance method". The depreciation under this method is calculated at a fixed percentage on the diminished value of the asset i.e., depreciation is calculated on the brought down balance of the asset. So, the amount of depreciation at the beginning year will be more when compared to the later year. So, the depreciation charged on every year goes on decreasing.

Advantages:

i) Fresh calculation of depreciation is not necessary as and when addition is made.

ii) The Asset is never completely written off, so that charged is made to revenue every year.

iii) Higher repair charges at the end of life of the asset are offset by lower amounts of depreciation.

iv) The method is recognized by income tax authorities as well as Companies Amendment Act, 1988.

Disadvantages

i) In this method, the calculation of depreciation is slightly complicated.

ii) The value of the asset cannot be brought down to zero.

iii) This method lays too much emphasis on the historical cost.

iv) It is difficult to determine the suitable rate of depreciation.

v) It does not provide funds to replace the assets.

Illustration No: 5

A trader purchased machinery for Rs.10.000 on 1.1.2016 Calculate depreciation @ 10% per annum under diminishing balance method for the first 4 years. Show the Machinery account.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.16	To Bank a/c	10,000	31.12.16	By depreciation	1,000
				By Balance C/d	9000
		10,000			10,000
01.01.17	To Balance B/d	9,000	31.12.17	By depreciation	900
				By Balance C/d	8100
		9,000			9,000
01.01.18	To Balance B/d	8,100	31.12.18	By depreciation	810
				By Balance C/d	7290
		8,100			8,100
01.01.19	To Balance B/d	7,290	31.12.19	By depreciation	729
				By Balance C/d	6,561
		7,290			7,290
01.01.20	To Balance B/d	6,561			

Illustration No: 6

Mr. Rao purchased a machine for Rs.44,000 on 1.7.2019 and spent Rs.6,000 on its erection on 31.12.2021 the machine became obsolete and was sold for Rs.40,000. Calculate depreciation @10% p.a. under Diminishing Balance Method. Show the Machinery account.

Profit Loss on sale of Assets:

Cost of Assets (44,000+6,000)	Rs.50,000
Less depreciation:	
2019	2,500
2020	4,750
2021	4,275
W.D.V. as on 31.12.2021	Rs.38,475
Less: amount realized on sale	Rs.40,000
Profit on the sale of machine	Rs.1,525

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
01.07.19	To Bank a/c (44000 + 6,000)	50,000	31.12.19	By depreciation	2,500
				By Balance C/d	47,500
		50,000			50,000
01.01.19	To Balance B/d	47,500	31.12.19	By depreciation	4,750
				By Balance C/d	42,750
		47,500			47,500
01.01.20	To Balance B/d	42,750	31.12.20	By depreciation	4,275
31.12.20	To P & L A/c (Profit on Sale)	1,525	31.12.20	By Bank A/c	40,000
		44,275			44,275

Illustration No: 7

On 1.1.2019 'X' purchased furniture worth Rs.25,000. On 1st July 2020 He purchased additional second-hand furniture worth Rs.5,000 and spent Rs.2,000 for its repairs.

Assuming the annual depreciation is charged @ 10% p.a. Prepare machinery account under diminishing Balance method for 3 years.

Dr. Furniture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.01.19	To Bank a/c	25,000	31.12.19	By depreciation	2,500
				By Balance C/d	22500
		25,000			25,000
01.01.20	To Balance B/d	22,500	31.12.20	By depreciation	2,600
01.07.20	To Bank a/c	7,000		(2,250 + 350)	
	(5,000 + 2,000)			By Balance C/d	26900
		29,500			29,500
01.01.21	To Balance B/d	26,900	31.12.21	By depreciation	2,690
				By Balance C/d	24,210
		26,900			26,900
01.01.22	To Balance B/d	24,210			

Illustration No:8

On 1.4.2019 a company purchased a machinery for Rs.30,000, Depreciation was provided @ 10% per annum on straight line method at the end of the year. With effect from 1.1.2020 the company decided to change the method of depreciation to Diminishing Balance Method @12% per annum. On 31.3.2021 the machinery became useless and sold for Rs.21,000. Prepare Machinery Account.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
01.04.20	To Bank a/c	30,000	31.12.20	By depreciation	2,250
				By Balance C/d	27,750
		30,000			30,000
01.01.21	To Balance B/d	27,750	31.12.21	By depreciation	3,330
				By Balance C/d	24,420
		27,750			27,750
01.01.22	To Balance B/d	24,420	31.03.22	By depreciation	733
			31.03.22	By Bank A/c	21,000
			31.03.22	To P & L A/c	2,687
				(Loss on Sale)	
		24,420			24,420

Short Answer Questions (2 Marks)

1. Define depreciation.
2. What are the causes of depreciation?
3. Write the main method of charging depreciation?
4. What is the need for providing depreciation?

Exercises (6 Marks)

Fixed Installment Method:

1. Furniture is purchased for Rs.35,000/-. It is decided to depreciate the asset on straight line method at 10% per annum. Show furniture account for 5 years.

   (Ans. Balance ₹ 17,500)

2. A machine is purchased for Rs.50,000. The rate of depreciation is to be charged at 20% per annum. Prepare machinery account for four years under Fixed installment method. **(Ans. Balance ₹ 10,000)**
3. A firm purchased a machine for Rs.1,00,000 on 1.4.2014. Show the machinery account for 4 years charging depreciation on Fixed installment Method @ 15% p.a. **(Ans. Balance ₹ 43,750)**
4. Mr. Ravi purchased a machine for Rs.68,000 on 1st January 2015. The residual value after 10 years is 8,000. Calculate depreciation chargeable under equal installment method at the end of 31st December of every year. Prepare machinery account for 3 years. **(Ans. Balance ₹ 50,000)**
5. A firm purchased a plant and machinery for Rs.40,000 on 1st January, 2015. The life of the asset was estimated to be four years and it was decided to depreciate 90% of the cost by straight line method over a period of estimated life. Show the plant and machinery account for 4 years.

   (Ans. Annual Depreciation ₹ 9,000, Balance on 1.1.19 ₹ 4,000)

Diminishing Balance Method:

6. On 1st January, 2016 a firm purchased a machine for Rs.30,000. Assuming the depreciation is charged @ 10% on diminishing balance method. Prepare machinery account for three years. **(Ans. Balance ₹ 21,870)**
7. A company purchased a plant worth Rs.25,000 on 31.3.2016 depreciation is calculate @10% per annum, under diminishing balance method. Show the machinery accounts up to 31st December, 2018. **(Ans. Balance ₹ 18,731)**

8. A company purchased a plant worth Rs.25,000 on 01.7.2015 the depreciation calculated @10% per annum. Under diminishing Balance Method. Show the machinery account up to 31st Dec 2018. **(Ans. Balance ₹ 17,313)**
9. Lee & Co. purchased a second-hand machine costing Rs.45,000 on 1st Jan 2015 and spent Rs.5,000 on its repairs. The depreciation is charged @15% p.a. on diminishing balance method. Prepare machinery account for the first four years. **(Ans. Balance ₹ 26,400)**

Sale of Asset:

10. Machinery bought on 1st Jan 2015 for Rs.20,000 has become obsolete and sold on 31st Dec, 2012 for Rs.13,000. Calculate the profit or loss assuming depreciation is charged @ 15% p.a. on straight line method. **(Ans. Profit ₹ 5,000**
11. Machinery purchased on 1.7.2009 for Rs.10,000 was sold on 31.12.2011 for Rs.5,000. Calculate the profit or loss of sale assuming depreciation is charged @ 10% per annum under fixed installment method. **(Ans. Loss ₹ 2,500)**
12. Furniture worth Rs.10,000 was purchased as on 1.1.2009. The furniture was sold on 31.12.2012 for Rs.6,000. Find the profit or loss on the sale of furniture charge depreciation @ 10% p.a. under diminishing balance method. **(Ans. Loss ₹ 925)**
13. A second-hand machine was purchased for Rs.12,000 on 1.1.2009 and Rs.3,000 spent towards repairs. On 30.6.2012 the machine became unsuitable and was sole for Rs.10,000. Charge depreciation @15% on Diminishing Balance Method. Show the machinery account. **(Ans. Loss ₹ 4,202)**
14. Furniture worth Rs.20,000 was purchased on 1.1.2010 and on 1.4.2011 additional furniture worth Rs.8000 was purchased and Rs.2,000 was spent on its erection. On 31.12.2011 furniture purchased on 1.1.2010 was sold for Rs.15,000. Prepare the furniture account up to 31.12.2012 charging depreciation @12% p.a. as per diminishing balance method. **(Ans. Loss ₹ 488, Balance ₹ 8008)**

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UNIT – V

JOINT VENTURE

Joint ventures – Features- Difference between joint venture and consignment, Accounting Procedure – Exercises.

Learning Objectives

After studying this unit, the student will be able to

- Understand about the features of joint venture.
- Understand about the differences between joint venture and consignment
- Understand about Accounting Procedure.

1. **Introduction:** A joint venture is a business agreement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific work/task. This task can be a new project or any other business activity. A joint venture is a very short duration "business" (generally confined to a single transaction, like buying some surplus stores and selling them) entered into by two or more persons jointly. Joint venture may be described as a temporary partnership between two or more persons without the use of the firm name, for a limited purpose.

   In other words, under joint venture two or more persons agree to undertake a particular venture (e.g., joint consignment of goods, joint construction of a building, joint underwriting of a particular issue of shares or debentures) and to share the profits and losses thereof in an agreed ratio (if agreement is silent on this point, then in equal ratio).

   Venture may be for the construction of a building or a bridge for the supply of certain quantity of materials or labour and even for the supply of technical services. The persons who have so agreed to undertake a joint venture are known as "Joint Ventures" or "Co-venturers". If the co-venturers are in business, then they often supply goods from their regular business for the venture. This limited partnership automatically expires on the completion of the venture for which it was formed.

1.1. Features of Joint Venture: Some important features of joint venture business are as follows:

i) It is short duration special purpose partnership, parties in venture are called Co-venturers.

ii) Co-venturers may contribute funds for running the venture of supply Inventories from their regular business.

iii) Co-venturers share profit/loss of the venture at an agreed ratio likewise partnership.

iv) Generally, profit/loss of the venture is computed on completion of the venture.

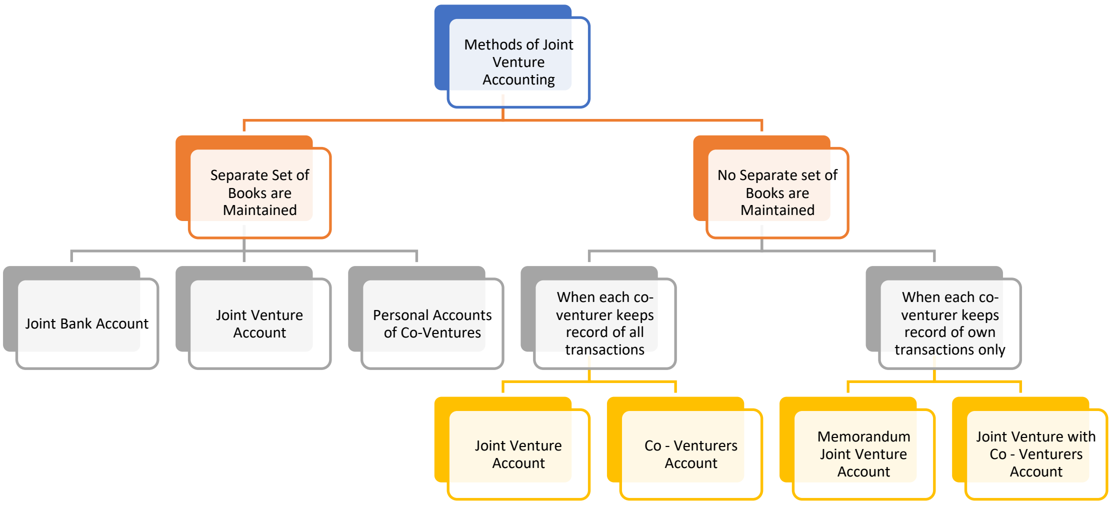
> Note: Going concern assumption of accounting is not appropriate for joint venture accounting. There does not arise problem of distinction between capital and revenue expenditure.

Plant, machinery and other fixed assets when used in venture are first charged to venture account at cost. On completion of venture such assets are revalued and shown as revenue of the venture. Thus, accounting approach for measurement of venture profit is totally different.

1.2. Differences Between Joint Venture and Consignment:

Joint Venture	Consignment
1. Co-ventures are partners in joint venture.	Relationship in consignment is between principal and agent.
2. All co-ventures are owner.	The consignor alone is the owner.
3. All co-ventures contribute -to the capital.	The consignor alone contributes the capital.
4. It is temporary partnership. It automatically terminates at the completion of the object.	Its period is longer than joint venture.
5. Profit is distributed among all co-ventures.	Profit belongs to the only.
6. There are four methods of keeping accounts.	There is only one method of keeping accounts.

1.3. Accounting Procedure: There are two methods of joint ventures accounting like as follows:



I. When Separate Set of Books are Maintained: When size of the venture is fairly big the co-venturers keep separate set of books of account for the joint venture. Joint venture transactions are separate from their regular business activities. In the books of joint venture, the following accounts are opened.

1. Joint bank account
2. Joint venture account
3. Personal accounts of the co-venturers or co-venturer's accounts

1. **Joint Bank Account:** The co-ventures open a separate bank account for the venture transactions by making initial contributions. The bank account is generally operated jointly. Expenses are met from this joint bank account. Also, sales or collections from transactions are deposited to this account. However sometimes the co-venturers may make direct payments and direct collections. On completion of the venture the joint bank account is closed by paying the balance to co-venturers.

2. **Joint Venture Account:** This account is prepared for measurement of venture profit. This account is debited for all venture expenses and is credited for all sales or collections. Venture profit/loss is transferred to co-venturer's accounts.

3. **Co-venturer's Accounts:** Personal accounts of the venturers are maintained to keep record of their contributions of cash, goods or meeting

venture expenditure directly and direct payment received by them on venture transactions. This account is also closed simultaneously with the closure of joint bank account.

The Following Journal Entries Are Necessary in The Books of Joint Venture:

Date	Particulars	L.F.No.	Debit ₹	Credit ₹
	1. For initial contribution by the Co-Venturers in joint bank account: -			
	Joint Bank A/c Dr		XXX	
	To Co - Venturers A/c			XXX
	(Being Cash Contribution made by the Co - Venturers.)			
	2. For goods that may be supplied by the Co - Venturers: -			
	Joint Venture A/c Dr		XXX	
	To Co - Venturers A/c			XXX
	(Being goods supplied by individual.)			
	3. For goods purchased for cash: -			
	Joint Venture A/c Dr		XXX	
	To Joint Bank A/c			XXX
	(Being goods purchased for cash.)			
	4. For goods purchased on credit: -			
	Joint Venture A/c Dr		XXX	
	To Supplier's A/c			XXX
	(Being goods purchased on credit.)			
	5. For payment of expenses: -			
	Joint Venture A/c Dr		XXX	
	To Joint Bank A/c			XXX
	(Being expenses paid.)			
	6. Expenses paid by co - venturer: -			
	Joint Venture A/c Dr		XXX	
	To Co - Venturers A/c			XXX
	(Being expenses paid by co - venturers.)			

	7. For credit bill paid to Suppliers: -			
	Supplier's A/c Dr		XXX	
	To Joint Bank A/c			XXX
	(Being credit bill paid.)			
	8. For sale of goods of joint venture: -			
	Joint Bank A/c (for cash) Dr		XXX	
	Customer's A/c (for credit) Dr		XXX	
	Co - Venturer's A/c (for taken by own) Dr		XXX	
	To Joint venture A/c			XXX
	(Being goods sold.)			
	9. For interest, commission and salary paid to Co - Venturer's: -			
	Joint Venture A/c Dr		XXX	
	To Co - Venturers A/c			XXX
	(Being interest/ commission/ salary to be Paid to Co - Venturer's)			
	10. For profit on joint venture: -			
	Joint Venture A/c Dr		XXX	
	To Co - Venturers A/c			XXX
	(Being profit on joint venture.)			
	11. For loss on joint venture: -			
	Co - Venturer's A/c Dr		XXX	
	To Joint venture A/c			XXX
	(Being loss on joint venture.)			
	12. Payment to Co - Venturers for Final Settlement: -			
	Co - Venturer's A/c Dr		XXX	
	To Joint Bank A/c			XXX
	(Being paid to Co - Venturers for final settlement.)			
	13. Cash received from Co - Venturers for Final Settlement: -			
	Joint Bank A/c Dr		XXX	

	To Co - Venturers A/c (Being cash received from Co - Venturers for final settlement. 14. For bad debts: - Joint Venture A/c Dr To Debtor's A/c (Being bad debts occurred.)		XXX	XXX XXX

Dr Proforma of Joint Bank Account Cr

Date	Particulars	₹	Date	Particulars	₹
	To Co - Venturers A/c (Initial Capital)	XXX		By Joint Venture A/c (Purchases)	XXX
	To Joint venture A/c (Cash Sales)	XXX		By Joint Venture A/c (Expenses)	XXX
	To Co - Venturers A/c (Received for Final Settlement)	XXX		By Supplier's A/c (Credit Bill)	XXX
				By Co - Venturer's A/c (Paid for Final Settlement)	XXX
		XXX			XXX

Dr Proforma of Co – Venturer's Account Cr

Date	Particulars	₹	Date	Particulars	₹
	To Joint venture A/c (Goods taken by own)	XXX		By Joint Bank A/c (Initial Capital)	XXX
	To Joint venture A/c (Loss transferred)	XXX		By Joint Venture A/c (For goods supply)	XXX
	To Joint Bank A/c (Received for Final Settlement)	XXX		By Joint Venture A/c (Expenses paid)	XXX
				By Joint Venture A/c (Interest/Commission paid)	XXX
				By Joint Venture A/c (Profit transferred)	XXX
				By Joint Bank A/c (Paid for Final Settlement)	XXX
		XXX			XXX

Dr Proforma of Joint Venture Account Cr

Date	Particulars	₹	Date	Particulars	₹
	To Co - Venturers A/c (For goods supply)	XXX		By Joint Bank A/c (For cash sales)	XXX
	To Joint Bank A/c (goods purchase)	XXX		By Customer's A/c (Credit sales)	XXX
	To Supplier's A/c (goods purchase on credit)	XXX		By Co - Venturer's A/c (Goods taken by own)	XXX
	To Joint Bank A/c (Expenses)	XXX		By Debtor's A/c (Bad debts)	XXX
	To Co - Venturers A/c (Expenses paid)	XXX		By Co - Venturer's A/c (Loss transferred)	XXX
	To Co - Venturers A/c (Interest/Commission paid)	XXX			
	To Co - Venturers A/c (Profit transferred)	XXX			
		XXX			XXX

Illustration: 1

A and B are entered into a joint venture or the sale of Plots. A Joint Bank Account was opened in which A deposited ₹ 3,00,000 and B ₹ 1,00,000. They Share Profit and Loss in the Ratio of their Capital.

A Land was purchased for ₹ 2,90,000, ₹ 30,000 were paid for Legal and registration charges. ₹ 80,000 were Incurred on Development of Land. The piece of Land was divided into 40 plots. 36 plots were sold for ₹ 522,000. They paid ₹ 22,000 for Brokerage on Sale of Plots. The Remaining Plots were Taken at Cost price by both A and B in their profit-sharing Ratio.

Make Journal Entries from above transactions & prepare Joint Venture A/c, Bank A/c and Co-venture Accounts.

Solution:

Journal Entries

Date	Particulars	L.F.No.	Debit ₹	Credit ₹
1	Joint Bank A/c Dr		400,000	
	To A A/c			300,000
	To B A/c			100,000
	(Being capital contributed.)			
2	Joint Venture A/c Dr		290,000	
	To Joint Bank A/c			290,000
	(Being land purchased.)			
3	Joint Venture A/c Dr		30,000	
	To Joint Bank A/c			30,000
	(Being legal & reg. expenses paid.)			
4	Joint Venture A/c Dr		80,000	
	To Joint Bank A/c			80,000
	(Being paid for development of land.)			
5	Joint Bank A/c Dr		522,000	
	To Joint Venture A/c			522,000
	(Being 36 plots sold.)			
6	Joint Venture A/c Dr		22,000	
	To Joint Bank A/c			22,000
	(Being brokerage paid.)			
7	A A/c Dr		30,000	
	B A/c Dr		10,000	
	To Joint Venture A/c			40,000
	(being stock taken by co - venturer's.)			
8	Joint Bank A/c Dr		140,000	
	To A A/c			105,000
	To B A/c			35,000
	(Being Profit distributed.)			
9	A A/c Dr		375,000	
	B A/c Dr		125,000	
	To Joint Bank A/c			500,000
	(Being balance distributed for final settlement.)			

Dr Joint Bank A/c Cr

Date	Particulars	₹	Date	Particulars	₹
	To A A/c	300,000		By Joint Bank A/c	290,000
	To B A/c	100,000		By Joint Venture A/c	30,000
	To Joint Venture A/c	522,000		By Joint Venture A/c	80,000
				By Joint Venture A/c	22,000
				By A A/c	375,000
				By B A/c	125,000
		922,000			922,000

Dr Joint Venture A/c Cr

Date	Particulars	₹	Date	Particulars	₹
	To Joint Bank A/c	290,000		By Joint Bank A/c	522,000
	To Joint Bank A/c	30,000		By A A/c	30,000
	To Joint Bank A/c	80,000		By B A/c	10,000
	To Joint Bank A/c	22,000			
	To A A/c 105,000	140,000			
	To B A/c 35,000				
		562,000			562,000

Dr Co – Venturer's Account Cr

Date	Particulars	A	B	Date	Particulars	A	B
	To Joint Venture A/c	30,000	10,000		By Joint Bank A/c	300,000	100,000
	To Joint Bank A/c	375,000	125,000		By Joint Venture A/c	105,000	35,000
		405,000	135,000			405,000	135,000

II. **Recording In the Books of Each Party:** When all co-venturers are not living at the same place and venture business is not so big enough than separate books of accounts for joint venture may not be kept. In such a situation co-venturers can record the transactions of joint venture in their own books also for this purpose.

Under this method each co – venturer will be preparing two accounts.

A. **Joint Venture Account:** it is a nominal account to find out the profit or loss of venture.

B. **Personal Account:** Personal account of the co – venturer to find out the amount due from or due to him. As the recording of transactions by both is a duplication of effort, it is enough if one of the co-venturers record these transactions. It should be understood that each co-venturer is having his own separate business and these transactions are in addition to what he records in respect of his independent business. A summary of various journal entries necessary to record the joint venture transactions in the books of any one co-venturer are given below: -

i. For cash advanced by the co – venturers:

Cash / Bank A/c………………………………….. Dr

To Co – Venturers A/c

(Being received advance.)

ii. For the purchase of goods for the venture:

Joint Venture A/c………………………………….. Dr

To Cash A/c

(Being goods purchased.)

iii. For recording the goods brought in by other co – venturers:

Joint Venture A/c………………………………….. Dr

To Co – Venturers A/c

(Being goods purchased by individual.)

iv. For recording the goods brought in by the venturer recording transactions:

Joint Venture A/c………………………………….. Dr

To Purchases A/c

(Being goods brought by the venturer.)

v. For paying expenses:

Joint Venture A/c………………………………….. Dr

To Cash A/c

(Being expenses paid.)

vi. For recording payment of expenses by one of the other co – venturers:

Joint Venture A/c………………………………….. Dr

To Co – Venturer A/c

(Being expenses paid by individual.)

vii. For sale of goods:

Cash A/c (for cash sales)…………………………. Dr

Debtors A/c (for credit sales)…………………….. Dr

To Joint Venture A/c

(Being goods sold.)

viii. For goods sold or taken away by the other Co – Venturers:
Co – Venturers A/c…………………………….... Dr
To Joint Venture A/c
(Being goods sold/taken by other co – venturer.)

ix. For goods taken away by the co – venturer recording transactions:
Purchases A/c…………………………….... Dr
To Joint Venture A/c
(Being goods sold/taken by co – venturer who recording transactions.)

x. Profit on Joint Venture:
Joint Venture A/c………………………………….. Dr
To Other Co – Venturer A/c (with their share)
To Profit and Loss A/c (with the share belonging who recording transactions)
(Being expenses paid by individual.)

xi. For settling the accounts:
Co – Venturers A/c…………………………….... Dr
To Cash A/c
(Being final settlement between the co – venturers.)

Illustration: 2:

Write journal entries and prepare ledger accounts in the books of Arya from the following particulars:

i) Arya from Vizag enters into a joint venture with Rajesh of Mumbai to ship cotton bales to Chauhan in Raipur.
ii) Arya sends cotton bales value of ₹ 50,000. He pays freight ₹ 2,000 and sundry expenses ₹ 1,500.
iii) Rajesh sends cotton bales value of ₹ 45,000 and pays ₹ 1,000 freight, ₹ 500 Dock charges, ₹ 1,000 custom charges.
iv) Arya paid advance to Rajesh ₹ 5,000 on account of the venture.
v) Rajesh received account sales and remittance of the net proceeds from Chauhan ₹ 105,000.

Solution:

Journal Entries in the books of Arya

Date	Particulars	L.F. No.	Debit ₹	Credit ₹
	Joint venture a/c Dr To Cash a/c (Being goods purchased for joint venture)		50,000	 50,000
	Joint Venture a/c Dr To Cash a/c (Being freight and sundry expenses paid)		3,500	 3,500
	Joint Venture a/c Dr To Rajesh a/c (Being goods sent to Chauhan)		45,000	 45,000
	Joint Venture a/c Dr To Rajesh a/c (Being dock, custom and freight charges paid)		2,500	 2,500
	Rajesh a/c Dr To Cash a/c (Being advance paid)		5,000	 5,000
	Rajesh a/c Dr To Joint Venture a/c (Being account sales received from Chauhan)		105,000	 105,000
	Joint Venture a/c Dr To Rajesh a/c To Profit and Loss a/c (Being distribution of profits)		4,000	 2,000 2,000
	Bank a/c Dr To Rajesh a/c (Being cash received for final settlement)		60,500	 60,500

Ledger Accounts:

Dr. Joint Venture Account Cr.

Date	Particulars		₹	Date	Particulars	₹
	To Cash A/c		50,000		By Rajesh A/c	105,000
	To Cash A/c		3,500			
	To Rajesh A/c		45,000			
	To Rajesh A/c		2,500			
	To Rajesh A/c	2,000	4,000			
	To Profit & Loss A/c	2,000				
			105,000			105,000

Dr. Rajesh Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Cash A/c	5,000		By Joint Venture A/c	45,000
	To Joint Venture A/c	105,000		By Joint Venture A/c	2,500
				By Joint Venture A/c	2,000
				By Bank A/c (C/d)	60,500
		110,000			110,000

III. Memorandum Method: When all parties keep accounts the method, adopted for recording the transactions relating to joint venture, is called 'Joint Venture Memorandum Method'. Following is the summary of the procedure adopted under this method:

i) Each venture opens one account on his books in which the records transactions relating to joint venture. In this method, every co-venturer prepares the following accounts:

— Memorandum Joint Venture Account

— Joint Venture with Co – Venturer Account

ii) The account is headed as: 'Joint Venture with ………… (Name of co – venture) account. This account is in the nature of personal account and does not disclose any profit or loss.

iii) Each party records only those transactions which are affected by him.

iv) When the transaction is recorded by the party, he does it with the help of 'joint venture with …... account'.

v) Profit is ascertained by preparing (memorandum) joint venture account. This account does not form part of the double entry system and hence the prefix memorandum. The method of preparing this account is very simple.

vi) Now each party finds the balance of the 'joint venture with ……… account' appearing in his book and settles the difference by paying/receiving cash.

vii) Journal Entries:

Joint Venture with Co – Venturer a/c Dr
To Cash a/c
<u>(Being goods supplied by Co – Venturer and Expenses paid)</u>

Bank a/c Dr
To Joint Venture with Co – Venturer a/c
<u>(Being goods sold)</u>

Joint Venture with Co – Venturer a/c Dr
To Commission a/c
To Interest a/c
<u>(Being commission and interest to be received)</u>

Purchases a/c Dr
To Joint Venture with Co – Venturer a/c
<u>(Being goods taken for personal use)</u>

Joint Venture with Co – Venturer a/c Dr
To Profit and Loss a/c
<u>(Being share on profits)</u>

Profit and Loss a/c Dr
To Joint Venture with Co – Venturer a/c
<u>(Being share on losses)</u>

Joint Venture with Co – Venturer a/c Dr
To Cash a/c
<u>(Being amount paid to co – venturer for final settlement)</u>

Cash a/c Dr

To Joint Venture with Co – Venturer a/c

(Being amount received to co – venturer for final settlement)

Illustration: 3

Chandini and Dharani decided to start a business, agreeing to share profit and losses in the ratio of 2:1.

i) On January 1, 2022 Chandini purchased goods at a cost of ₹ 5,600 and half of the goods were handed over to Dharani. On January 15, she again purchased goods worth ₹ 2,400. He incurred expenses of ₹ 500.

ii) On January 15, Dharani also made a purchase of ₹ 2,500 and on the same day she sent to Chandini goods worth ₹ 1,000 and she incurred expenses of ₹ 250.

iii) On January 20, Chandini in order to help Dharani sent ₹ 1,000 to her.

iv) Goods sold by Chandini ₹ 6,700; ₹ 6,000 by Dharani.

v) On January 30, Chandini had unsold stock of goods of ₹ 750, of these goods costing ₹ 300. were taken away by her.

vi) Dharani was able to sell away complete goods excepting goods costing ₹ 150 which were badly damaged and were treated as unsaleable ₹ 200 owing to Chandini was unrecoverable and treated as joint loss.

vii) On January 30, parties decided to close the books. Ignore interest.

You are required to prepare Joint venture with Dharani account as it would appear in the books of Chandini and

To prepare Memorandum Joint Venture Account showing the profits of the business.

Solution:

Date	**Particulars**	**₹**	**Date**	**Particulars**		**₹**
1.1.22	To Purchases	5,600	2.1.22	By Sales	6,700	
15.1.22	To Purchases	2,400		Less: bad debts	200	6,500
20.1.22	To Cash (Expenses)	500	30.1.22	By Stock taken over		300
30.1.22	To Cash to Dharani	1,000	30.1.22	By Cash from Dharani (c/d)		3,733
30.1.22	To Profits (b/d from Memorandum joint venture a/c)	1,033				
		10,533				10,533

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.22	To Purchases (Chandu)	5,600	30.1.22	By Sales:	
15.1.22	To Purchases:			Chandini	6,700
	Chandini	2,400		Dharani	6,000
	Dharani	2,500	30.1.22	By Stock (Chandini)	300
15.1.22	To Expenses:				
	Chandini	500			
	Dharani	250			
30.1.22	To Bad debts	200			
30.1.22	To Net Profit:	1,550			
	Chandini 1033				
	Dharani 517				
		13,000			13,000

Short Answer Questions (2 Marks)

1. What is Joint Venture?
2. What Joint Bank Account?

Essay Answer Questions (6 Marks)

1. What are the differences between Joint Venture and Consignment?

Exercises

I. To Maintain a Separate Sets of Books:

1. X. Y, Z are started joint venture business and they decided to share profits equally. They bought goods from A ₹ 1,50,000. X, Y, Z Contributed capitals ₹ 60,000; ₹ 60,000; 70,000 respectively and deposited this amount into joint bank account. They settled A's account with cheque. They paid ₹ 10,000 for carriage and other expenses. They sold goods for cash ₹ 100,000 and Credit ₹ 80,000 to B. They received bill from B and discounted at 5% immediately. 2% commission to be paid to X.

   Pass necessary journal entries and prepare ledger accounts.

   (Joint venture profit ₹ 12,400; Final settlement to Co – Venturers is X ₹ 67,733; Y ₹ 64,133; Z ₹ 74,134.)

2. Munikanna and Seenappa entered into a joint venture for the purchase and sale of plastic goods. They agreed to share profits and losses in the ratio of 2:1 respectively.

Their business transactions are as follows:

2020 April 1	Munikanna and Seenappa paid into a joint account ₹ 36,000 and ₹ 18,000 respectively.
2020 April 5	Paid rent of the shop ₹ 600
2020 April 9	Purchased goods for cash ₹ 36,000; paid carriage ₹ 500.
2020 April 14	Munikanna paid advertising ₹ 100 from his private account.
2020 April 18	Sold goods and money deposited into joint account ₹ 19,600.
2020 April 22	Sold goods for cash ₹ 26,000.
2020 April 25	Purchased goods for cash ₹ 6,000. And expenses paid ₹ 60 by Seenappa from his private account.
2020 April 27	Sold goods for cash ₹ 14,000.
2020 April 30	Munikanna took away the balance of goods ₹ 4,000.

Prepare necessary ledger accounts.

(Joint venture profit ₹ 20,340; Final settlement to Munikanna ₹ 45,660; Seenappa ₹ 24,840.)

II. Recording in the Books of Each Party:

3. Venky and Vijay are equal partners. They entered into joint venture business. ₹ 2,500 goods supplied by Venky and spent ₹ 200. Vijay supplied goods ₹ 2,000 and spent ₹ 200. Vijay sold goods for ₹ 6,000. Commission on sales 5% to be paid to Vijay. Vijay send bank draft to Venky for final settlement. Prepare Joint Venture A/c and Vijay A/c in the books of Venky.

   (Joint venture profit ₹ 800; Final Settlement to Venky ₹ 3,100.)

4. Maha and Mani is entered into joint venture business. Particulars are below:

   i) Goods supplied: -

   Maha ₹10,000

   Mani ₹ 6,000

   ii) Expenses:

   Maha ₹1,000

   Mani ₹ 600

   iii) Commission 5% on sales paid to Mani. (Goods sold by Mani ₹ 22,000).

   Mani sent bank draft to Maha for final settlement. Prepare Joint Venture A/c and Mani A/c in the books of Maha.

   (Joint venture profit ₹ 3,300; Final Settlement to Maha ₹ 12,650.)

III. Memorandum Method:

5. Ravi and Raju decided to start a joint venture business. They agreed to share profits in the ratio of 3:2. Transactions are below:

   Ravi transactions are:

   i) Bought 8 Cars for ₹ 75,000

   ii) Expenses ₹ 3,000.

   iii) Sales ₹ 100,000.

   Ravi transactions are:

   i) Bought 5 Cars for ₹ 50,000

   ii) Expenses for insurance ₹ 1,000 and repairs ₹ 1,000.

   iii) Sales ₹ 75,000.

   Prepare Memorandum of Joint Venture A/c in the books of Ravi.

   (Joint venture profit ₹ 45,000)

6. David and Madhu are equal partners, they entered into joint venture business. Their business transactions are below:

   David transactions are:

   i) Bought 10 trucks for ₹ 100,000

   ii) Paid insurance and taxes ₹ 5,000

   iii) Sales ₹ 1,50,000

   Madhu transactions are:

   i) Bought 8 trucks for ₹ 75,000

   ii) Expenses for rent, rates ₹ 3,000

   iii) Sales ₹ 100,000.

   Prepare Memorandum of Joint Venture A/c in the books of David.

   (Joint Venture Profit ₹ 67,000)

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UNIT – VI

PARTNERSHIP ACCOUNTS

Partnership Accounts: Definition – Admission of a Partner - Accounting Treatment – Exercises. Retirement of partner – Accounting Treatment – Exercises.

Learning Objectives

After studying this unit, the student will be able to

- ☞ Understand about Partnership Business
- ☞ Understand about the admission of a partner
- ☞ Understand about the retirement of a partner

1. Introduction: A business may be organised in the form of a sole proprietorship, a partnership firm or a company. The sole proprietorship has its limitations such as limited capital, limited managerial ability and limited risk - bearing capacity. Hence, when a business expands, it needs more capital and involves more risk. Then two or more persons join hands to run it. They agree to share the capital, the management, the risk and the Profit or Loss of the business. Such mutual relationship based on agreement among these persons is termed as "Partnership". The persons who have entered into partnership are individually known as 'Partners' and collectively as 'Firm'.

1.1. Definition: The Indian Partnership Act 1932, Section 4, defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Persons who have entered into partnership with one another are individually called 'partners' and collectively called 'firm'. The name under which the business is carried is called the 'firm's name'. A partnership firm has no separate legal entity, apart from the partners constituting it.

1.2. Partnership Deed: Agreement to carry on a business between the partners, partnership comes into existence. The partnership agreement can be either oral or written. The Partnership Act does not require that the agreement must be in writing.

But when the agreement is in written form, it is called 'Partnership Deed'. Partnership deed should be duly signed by the partners, stamped & registered.

Partnership deed generally contains the following details:

- Names and Addresses of the firm and its main business;
- Names and Addresses of all partners;
- A contribution of the amount of capital by each partner;
- The accounting period of the firm;
- The date of commencement of partnership;
- Rules regarding an operation of Bank Accounts;
- Profit and loss sharing ratio;
- The rate of interest on capital, loan, drawings, etc;
- Mode of auditor's appointment, if any;
- Salaries, commission, etc, if payable to any partner;
- The rights, duties, and liabilities of each partner;
- Treatment of loss arising out of insolvency of one or more partners;
- Settlement of accounts on the dissolution of the firm;
- Method of a settlement of disputes among the partners;
- Rules to be followed in case of admission, retirement, a death of a partner; and;
- Any other matter relating to the conduct of business. Normally, all the matters affecting the relationship of partners amongst themselves are covered in partnership deed.

1.3. Accounting rules applicable in the absence of Partnership deed: Normally, a partnership deed covers all matters relating to mutual relationship among the partners. But, in the absence of agreement, the following provisions of the Indian Partnership Act, 1932 shall apply for accounting purposes.

1. **Interest on Capital:** No interest is allowed on Capitals of the Partners. If as per the partnership deed, interest is allowed, it will be paid only when there is profit. If loss, no interest will be paid.
2. **Interest on Drawings:** No interest will be charged on drawings made by the partners.

3. **Salary/Commission to partner:** No partner is entitled to salary/ commission from the firm, unless the partnership deed provides for it.
4. **Interest on loan:** If any partner, apart from his share capital, advances money to the firm as loan, he is entitled to interest on such amount at the rate of six percent per annum.
5. **Profit sharing ratio:** The partners shall share the profits of the firm equally irrespective of their capital contribution.

1.4. Special Aspects of Partnership Accounts and its Maintenance: Accounting Treatment for partnership firm is similar to that of a sole proprietorship business with the exception of the following aspects:

1. Distribution of Profit/Loss among partners
2. Maintenance of Partner's Capital Accounts
3. Reconstitution of the Partnership Firm
4. Dissolution of Partnership Firm

1.4.1.Distribution of Profit among Partners: In accordance with the provisions of the Partnership deed, the profits and losses made by the firm are distributed among the partners. However, sharing of profit and losses is equal among the partners, if the partnership deed is silent.

However, certain adjustments such as interest on drawings & capital, salary & commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm. The final figure of profit and loss to be distributed among the partners is ascertained by Profit and Loss Appropriation Account.

Profit and Loss Appropriation Account: After the Profit and Loss Account, Profit and Loss Account Appropriation is prepared for the firm. In this account how the profit or loss among the partners of the firm is distributed is shown. Through this account, all adjustments in respect of partner's salary, partner's commission, interest on capital, interest on drawings, etc. are made.

It starts with the net profit/net loss as per Profit and Loss Account is transferred to this account.

The Performa of Profit and Loss Appropriation Account is given as follows:

Dr. Profit and Loss Appropriation Account Cr.

Particulars	₹	Particulars	₹
To Profit and Loss	XXX	By Profit and Loss	XXX
(If there is a loss)	XXX	(If there is profit)	
To Interest on capital	XXX	By Interest on drawings	XXX
To Salary to Partner	XXX	By Partners' Capital a/c	XXX
To Commission to Partner	XXX	(Distribution of loss)	
To Interest on Partner's Loan	XXX		
To Partner's Capital a/c	XXX		
(Distribution of profit)			
	XXX		XXX

Illustration:1

Akash, Bhanu and Chandu set up a partnership firm on April 1, 2021. They contributed ₹ 50,000, ₹ 30,000 and ₹20,000, respectively as their capitals and agreed to share profits and losses in the ratio of 5:3:2. Akash Salary is ₹ 1,000 per month and Bhanu's Commission of ₹10,000. Interest on capital at 10% p.a.

The drawings for the year were Akash ₹ 10,000, Bhanu ₹ 5,000 and Chandu ₹ 2,000. Interest on drawings of ₹ 1,000 was charged on Avinash drawings, ₹ 500 on Balaji drawings and ₹ 200, on Chandu drawings. The net profit as per Profit and Loss Account for the year ending March 31, 2021 was ₹ 36,300.

Prepare the Profit and Loss Appropriation Account to show the distribution of profit among the partners.

Solution:

Profit and Loss Appropriation Account

Dr. Cr.

Particulars	₹	₹	Particulars	₹	₹
To Salary to Akash		12,000	By Profit and Loss		36,300
To Interest on capital			By Interest on drawings		
Akash	5,000		Akash	1,000	
Bhanu	3,000		Bhanu	500	
Chandu	2,000	10,000	Chandu	200	1,700
To Commission to Bhanu		10,000			
To Partner's Capital a/c (Distribution of profit)		6,000			

Akash Bhanu Chandu	3,000 1,800 1,200				
		38,000			38,000

1.4.2.Maintenance of Partner's Capital Accounts: Most of the transactions relating to the partners of the firm are recorded in the books of the firm through their capital accounts. This includes various transactions like money brought in by the partner, withdrawal of the capital, the share of profit, interest on drawings, interest on capital, etc.

There are 2 methods by which the capital of the partners is maintained. These special aspects accounts are:

a. **Fixed Capital Method and**
b. **Fluctuating Capital Method.**

a. **Fixed Capital Method:** Under this method, a firm maintains two capital accounts in order to keep the capital account balance stable from regular capital related transactions. These accounts are as follows:

a. Capital Account and
b. Current Account.

Capital Account only includes transactions like Initial investment, an addition of capital and permanent withdrawal of capital.

b. **Fluctuating Capital Method:** Under this method, a firm records all the capital related transaction (Permanent as well as non-Permanent) under a single account and that is Capital Account.

Format: (Fixed Capital Method):

Capital Accounts

Particulars	x	y	z	Particulars	x	y	z
To balance c/d	xxx	xxx	xxx	By balance b/d	xxx	xxx	xxx
	xxx	xxx	xxx	By balance b/d	xxx	xxx	xxx
					xxx	xxx	xxx

Current Accounts

Particulars	x	y	z	Particulars	x	y	z
To drawings To interest on drawings To revaluation a/c (if loss) To balance c/d	xx xx xx xx	xx xx xx xx	xx xx xx xx	By balance b/d By interest on capital By commission By salary By revaluation a/c	xx xx xx xx xx	xx xx xx xx xx	xx xx xx xx xx
	xxx	xxx	xxx		xxx	xxx	xxx

Format: (Fluctuating Capital Method)

Capital Accounts

Particulars	x	y	z	Particulars	x	y	z
To drawings To interest on drawings To revaluation a/c (if loss) To balance c/d	xx xx xx xx	xx xx xx xx	xx xx xx xx	By balance b/d By interest on capital By commission By salary By revaluation a/c	xx xx xx xx xx	xx xx xx xx xx	xx xx xx xx xx
	xxx	xxx	xxx		xxx	xxx	xxx

Preparation of Capital Accounts

Illustration 2: Show how the following items will appear in the capital accounts of the partners, Amith and Bhushan.

	Amith ₹	Bhushan ₹
Capital on 1.4.2020	90,000	70,000
Drawings during 2020 – 2021	12,000	9,000
Interest on drawings	360	270
Interest on capital	5,400	4,200
Partners Salary	12,000	-
Commission	-	6,000
Share of profit for 2020 –21	6,000	4,000

Solution:

a) When capital accounts are fixed:

Capital Accounts

Particulars	Amith	Bhushan	Particulars	Amith	Bhushan
To balance c/d	90,000	70,000	By balance b/d	90,000	70,000
	90,000	70,000		90,000	70,000
			By balance b/d	90,000	70,000

Current Accounts

Particulars	Amith	Bhushan	Particulars	Amith	Bhushan
To drawings	12,000	9,000	By interest on capital	5,400	4,200
To interest on drawings	360	270	By commission	12,000	6,000
To balance c/d	11,040	4,930	By salary		
			By profit & loss a/c	6,000	4,000
	23,400	14,200		23,400	14,200
			By balance b/d	11,040	4,930

b) When capital accounts are fluctuating:

Capital Accounts

Particulars	Amith	Bhushan	Particulars	Amith	Bhushan
To drawings	12,000	9,000	By balance b/d	90,000	70,000
To interest on drawings	360	270	By interest on capital	5,400	4,200
To balance c/d	101,040	74,930	By commission	12,000	6,000
			By salary		
			By profit & loss a/c	6,000	4,000
	113,400	84,200		113,400	84,200
				101,040	74,930

Illustration 3: Write up the capital and current accounts of the partners, Kavitha and Jyothi from the following:

	Kavitha ₹	Jyothi ₹
Capital on 1.1.2014	1,50,000	1,00,000
Current accounts on 1.1.2014 (Cr.)	20,000	15,000
Drawings during 2014	30,000	40,000
Interest on drawings	900	1,000

Share of profit for 2014	10,000	8,000
Interest on Capital	6%	6%

Capital Accounts

Particulars	Kavitha	Jyothi	Particulars	Kavitha	Jyothi
To balance c/d	150,000	100,000	By balance b/d	150,000	100,000
	150,000	100,000		150,000	100,000
			balance b/d	150,000	100,000

Current Accounts

Particulars	Kavitha	Jyothi	Particulars	Kavitha	Jyothi
To drawings	30,000	40,000	By balance b/d	20,000	15,000
To interest on drawings	900	1,000	By interest on capital	9,000	6,000
To balance c/d	8,100		By profit & loss a/c	10,000	8,000
			By balance c/d		12,000
	39,000	41,000		39,000	41,000
To balance b/d		12,000	By balance b/d	8,100	

1.5. Goodwill: When a firm is reconstituted, goodwill is valued and shared by the existing partners. Goodwill is the present value of a firm's anticipated excess earnings in future and the efforts had already made in the past. Goodwill really arises only if firm is able to earn higher profit than normal.

Meaning and Nature Goodwill is the value of the reputation of the firm which the business builds up due to its efficient service to its customers and quality of its products. It is a value of all favourable attributes relating to a business enterprise. It is not merely the past reputation but its continued existence in future that makes goodwill a valuable asset. It cannot be seen or touched. It is an intangible asset but not a fictitious asset.

Methods of valuation of goodwill: There are three methods of valuation of goodwill. They are:

1. Average Profit method
2. Super Profit method
3. Capitalisation method

1. **Average profit method**: In this method, past profits of a number of years are taken into account. Such profits are added and the average profit is found out. The average profit is multiplied by a certain number of years to arrive at the value of goodwill. The steps involved under this method are:

   Step 1 → Calculate total profits by adding each year's profit and deducting loss, if any.

   Step 2 → Calculate the average profit by applying the following formula.

   Average Profit =Total Profits / No of years.

   Step 3 → Calculate the Goodwill by applying the following formula.

   Goodwill = Average Profit X No. of years' purchase

Illustration 4:

The Goodwill is to be valued at two years' purchase of last four years average profit. The profits were Rs.40,000, Rs.32,000, Rs.15,000 and Rs.13,000 respectively. Find out the value of goodwill.

Solution:

a) Calculation of average profit:

I year	40,000
II year	32,000
III year	15,000
IV year	13,000
Total Profit	1,00,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No of years}}$$

$$= \frac{1,00,000}{4}$$

= 25000

Calculation of Goodwill:

Goodwill = Average Profit X two years' purchase

= 25,000 X 2 = Rs. 50,000.

2. **Super Profit method:** The excess of average profit over normal profit is called super profit. The goodwill under the Super profit's method is calculated by multiplying the super profits by certain number of years purchase. The steps involved under this method are:

Step 1 → Calculate the average profit – it may be adjusted for partners remuneration.

Step 2 → Calculate the normal profit on capital employed by applying the following formula.

Normal Profit = Capital employed X Normal rate of return

Step 3 → Calculate the super profit.by applying the following formula.

Super profit = Average Profit – Normal profit

Step 4 → Calculate the value of goodwill by multiplying the amount of super profit by the given number of years' purchase

Goodwill = Super Profit X No. of years of purchase

3. **Capitalisation Method:** of Average Profits: Under this method, the value of goodwill is ascertained by deducting the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return.

Goodwill = capitalised Value – Capital Employed

Capital Employed = Total Assets – Outside Liabilities

Illustration 5:

A firm's net profits during the last three years were Rs.90,000 Rs.1,00,000 and Rs.1,10,000. The capital employed in the firm is Rs.3,00,000. A normal return on the capital is 10%. Calculate the value of goodwill on the basis of two years' purchase of super profit.

Solution:

a. Calculation of average profit:

I year	90,000
II year	1,00,000

III year 1,10,000

3,00,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No of years}}$$

$$= \frac{3,00,000}{3}$$

$= 1,00,000$

b. Calculation of Normal Profit:

Normal Profit = Capital employed X Normal rate of return

$$\frac{3,00,000 \times 10}{100}$$

$= 30,000$

c. Calculation of Super Profit:

Average Profit – Normal Profit = 1,00,000 – 30,000 = ₹ 70,000.

Goodwill at two years' purchase of super profit: Goodwill =

Super Profit X No. of years of purchase = 70,000 X 2 = ₹ 1,40,000

1.6. New Profit-Sharing Ratio: There are different cases when partnership can have new profit-sharing ratio:

- Sometimes the partners may decide to change their existing profit-sharing ratio, without any admission or retirement of partner,
- At the time of admission of the new partner
- At the time of retirement or death of an old partner

  This may result in a gain to a few partners and loss to others. The partners who are in profit due to this change in the profit-sharing ratio should compensate the sacrificing partner/partners.
- **New profit-sharing ratio:** Ratio in which the partners decide to share profits/losses in future.

- **Gaining ratio:** Ratio in which the partners have agreed to gain their share of profit from other partners.
- **Sacrificing ratio:** Ratio in which the partners have agreed to sacrifice their share of profit in favour of other partners. Sacrificing ratio = Old Ratio – New Ratio

New profit-sharing ratio: When a new partner is admitted, he should be given a portion of the profit of the firm. As the incoming partner is entitled to get a profit share, the profit share of all or some of the old partners will be reduced.

The profit shares of all the old partners will be reduced, if all of them make a sacrifice. What the old partners sacrifice, is in favour of the new partner. Thus, Profit Sharing Ratio should necessarily be changed when a new partner is admitted.

The ratio at which the profits should be divided among the old partners and the new partners is called the New Profit-Sharing Ratio. After the admission of a new partner into the firm, New Profit-Sharing Ratio should be found out, without which the profit cannot be divided among partners, including the new partner.

The following cases may arise while calculating the new Profit and Loss sharing ratio:

a. When the share of the new partner is given, then it should assume that the remaining profit should be shared by the old partners in their old profit-sharing ratio.
b. When the share of the new partner is purchased out of the share of profit of one of the old partners, then the old partner forgoes a portion of the profit, which goes to the new partner.
c. The old partners may sacrifice their share of profits for the new partner in their existing profit-sharing ratio.
d. New partner’s share of profit is out of the profit of all partners in the equal ratio.

In all the cases, profit and loss sharing ratio is completely changed. All the types of cases are discussed below:

New Profit-Sharing Ratio

When a new partner is admitted then the calculation of new profit-sharing ratio becomes necessary. The reason behind that is the new partner acquires his share of profit from the old partners. Hence, old partners' shares reduce.

a) **When only the ratio of new partner is given**: In this case in the absence of any other agreement, it is presumed that the old partners will continue to share the remaining profits in the same ratio in which they were sharing before the admission of the new partner.

Example: X, Y and Z are partners in proportion of 3/6, 2/6 and 1/6 respectively. P was admitted in the firm as a new partner with $1/6^{th}$share. Calculate the new profit-sharing ratios of the partners.

Solution:

Let total profit be = 1

Share given to P = 1/6

Remaining Share = 1 – 1/6 = 5/6

Now the old partners will share this remaining profit in their old profit-sharing ratios. Hence,

X's share = 3/6 of 5/6 = 5/12

Y's share = 2/6 of 5/6 = 5/18

Z's share = 1/6 of 5/6 = 5/36

Thus, the new profit-sharing ratio will be

X: Y : Z : P

5/12 : 5/18 : 5/36 : 1/6 =

15 : 10 : 5 : 6

b) **When the new partner purchases his share of profit from the old partners equally:** In such cases, the new profit-sharing ratio of the old partners can be calculated by deducting the sacrifice made by them from their existing share of profit.

Example: A and B are partners sharing profits and losses in the ratio of 7/12 : 5/12. They admit C as a new partner for 1/6th share, which he acquires equally from A and B. Calculate the new profit-sharing ratios of the partners

Solution:

Share of profits given to C = 1/6

Share acquired by C from A = ½ of 1/6 = 1/12

Share acquired by C from B = ½ of 1/6 = 1/12

Therefore,

A's new share = 7/12 – 1/12 = 6/12

B's new share = 5/12 – 1/12 = 4/12

C's share = 1/6

Hence, new profit-sharing ratio will be

A	:	B	:	C
6/12	:	4/12	:	1/6 =
3	:	2	:	1

c) **When new partner purchases his share from the old partners in a particular ratio:** In this case, the new profit-sharing ratio of the old partners will be ascertained after deducting the sacrifice made by them from their existing share of profit.

Example: X and Y are partners in a firm sharing profits in the ratio of 7 : 5. Z is admitted on 1/6th share which he takes 1/24th from X and 1/8th from Y. Calculate the new profit sharing of the partners.

Solution:

X's old share = 7/12, out of which he surrenders 1/24th in favour of Z.

Therefore, X's new share = 7/12 – 1/24 = 13/24

Y's old share = 5/12, out of which he surrenders 1/8th in favour of Z.

Therefore, Y's new share = 5/12 – 1/8 = 7/24

Z's share = 1/6

Hence, new profit-sharing ratio will be

X	:	Y	:	Z
13/24	:	7/24	:	1/6 =
13	:	7	:	4

d) When old partners surrender a particular fraction of their share in favour of the new partner: in such case, the new partner's share is calculated by adding the surrendered portion of share by the old partners.

Example: P and Q are partners in a firm sharing profits and losses in the ratio of 3:2. A new partner R is admitted. P surrenders 1/5th share of his profit in favour of R and Q 2/5th share of his profit in favour of R. Calculate the new ratio of the partners.

Solution:

P's old share = 3/5

P surrenders 1/5th of 3/5 in favour of R i.e. 1/5 X 3/5 = 3/25

Q's old share = 2/5

Q surrenders 2/5th of 2/5 in favour of R i.e. 2/5 X 2/5 = 4/25

P's new share after surrendering 3/25 in favour of R = 3/5 – 3/25 = 12/25

Q's new share after surrendering 4/25 in favour of R = 2/5 – 4/25 = 6/25

R's share is the total of 3/25 from P and 4/25 from Q = 3/25 + 4/25 = 7/25

Therefore, new ratio will be

P	:	Q	:	R	
12/25	:	6/25	:	7/25	=
12	:	6	:	7	

1.7. Gaining Ratio: Gaining ratio is calculated at the time of retirement or death of a partner. It is the ratio in which the remaining partners acquire the outgoing partner's share of profit.

When the partner retires, the profit-sharing ratio of the continuing partners gets changed. Continuing partners distribute the share of retiring partner among them.

Gaining ratio= New Ratio – Old Ratio (if positive)

Examples:

Various cases of new ratio and gaining ratio are explained as follows:

Case 1: When the share of retiring partner is acquired by old partners in an old ratio:

Amit, Summit, and Punit share profit and losses in the ratio of 3:2:1, respectively. Amit retires and the remaining partners decide to share to take Amit's share in the existing ratio i.e., 2:1. Calculate the new ratio and gaining ratio.

Solution:

The existing ratio between Summit and Punit= 2/6 and 1/6

Amit's ratio (retiring partner) = 3/6

Amit's share taken by Summit and Punit in the ratio of 2:1

Summit gets = 3/6 * 2/3 = 6/18

Punit gets = 3/6 * 1/3 = 3/18

New ratio between Summit and Punit is = 6:3 = 2:1

Gaining ratio= New Ratio – Old Ratio

Summit's gain = 2/3 – 2/6 = 2/6

Punit's gain = 1/3 – 1/6 = 1/6

Gaining ratio = 2:1

New Ratio = 2:1

Case 2: When the share of retiring partner is acquired by old partners in old specified proportions:

Amit, Summit, and Punit share profit and losses in the ratio of 2:3:1, respectively. Amit retires and the remaining partners decide to share to take Amit's share equally. Calculate the new ratio and gaining ratio.

Solution:

The existing ratio between Summit and Punit= 3/6 and 1/6

Amit's ratio (retiring partner) = 2/6

Amit's share taken by Summit and Punit in the ratio of 1:1

Summit gets = 2/6 * 1/2 = 1/6

Summit's new share = 3/6 + 1/6 = 4/6

Punit gets = 2/6 * 1/2 = 1/6

Punit's new share = 1/6 + 1/6 = 2/6

New ratio between Summit and Punit is = 4:2 = 2:1

Gaining ratio is given the question i.e., 1:1

Gaining ratio = 1:1

New Ratio = 2:1

Case 3: When the share of retiring partner is acquired fully by one of the continuing partners:

Amit, Summit, and Punit share profit and losses in the ratio of 4:5:2, respectively. Amit retires and Punit acquires Amit's share. Calculate the new ratio and gaining ratio.

Solution:

Punit's new share = 2/11 + 4/11 = 6/11

Summit share remains unchanged = 5/11

The new ratio between Summit and Punit is = 5:6

Gaining ratio in this case between Summit and Punit will be

Summit's gain = 5/11 – 5/11 = Nil

Punit's gain = 6/11 – 2/11 = 4/11

This shows that entire gain is taken by Punit.

1.8. Scarifying Ratio:

Illustration 6:

A and B are partners sharing profits and losses in the ratio of 5: 3. They admit C as a partner. C requires his share i.e., 4/20 from A and 2/20 from B. Find out the new profit-sharing ratio and sacrificing ratio.

Solution:

A old ratio = 5/8

A sacrifice to C = 4/20

A new share = 5/8 - 4/20= 50-16/80 = 34/80

B old ratio = 3/8

B sacrifices to C = 2/20

B new share = 3/8 – 2/20 = 30-8/80 = 22/80

C's share = 4/20 + 2/20 = 6/20 or 24/80

New ratio of A, B and C = 34:22:24 or 17:11:12

Sacrificing Ratio = 2:1

Illustration 7:

A and B are partners sharing profit and loss in the ratio of 7:5. They take C into the partnership. C is given 1/6th share which he acquires 1/24 from A and 1/8 from B. Calculate the future profit-sharing ratio and also sacrificing ratio.

Solution:

Computation of profit-sharing ratio:

Old Ratio – Sacrificing Ratio – New Ratio

Illustration 8:

A and B are partners sharing profit and loss in the ratio of 7:5. They take C into the partnership. C is given 1/6th share which he acquires 1/24 from A and 1/8 from B. Calculate the future profit-sharing ratio and also sacrificing ratio.

Solution:
Computation of profit-sharing ratio:

Old Ratio – Sacrificing Ratio – New Ratio (or) OR – SR – NR

A – 7/12 – 1/24 = 14 – 1 /24 = 13/24

B – 5/12 – 3/24 = 10 – 3 /24 = 7/24

C – 1/24 + 1/8 = 1 + 3/24 = 4/24

Future profit-sharing ration of A, B and C = 13:7:4

Sacrificing Ratio (given) = 1:3

Admission of a New Partner

2.0. Introduction: A Partnership firm suffering from shortage of funds or administrative in capabilities may decide to admit a partner. Admission of a partner is one of the modes of reconstituting the firm. According to Section 31 (1) of the Indian Partnership Act 1932, a person can be admitted only with the consent of all the existing partners. A person who is admitted to the firm is known as an incoming or a new partner. On admission of a new partner, the existing partnership comes to an end and a new partnership comes into effect. In other words, a new firm is reconstituted under a fresh agreement.

Whenever a partner is admitted into the partnership firm, he acquires two rights.

e. Right to share the assets of the partnership firm.
f. Right to share the future profits of the partnership firm.

The amount that the new partner brings in for the right to share in the partnership assets is called his capital and is credited to his Capital account. Whereas the consideration which he pays to the old partners for the right to participate in the division of future profits is called Goodwill.

2.1. Admission of a Partner – Accounting Treatment (Adjustments): While admitting a new partner, the following adjustments are necessary:

a. Recording the Capital of a new partner.
b. Calculation of New Profit-Sharing ratio and Sacrificing ratio.
c. Revaluation of assets and liabilities.
d. Transfer of Undistributed Profit or loss.
e. Transfer of Accumulated reserves.
f. Treatment of Goodwill.

2.2. Revaluation Of Assets and Liabilities: Revaluation is the valuation of assets and liabilities at the time of reconstitution of the partnership firm. At the time of admission of a partner, the assets and liabilities are revalued so that the profit and loss arising on account of such revaluation may be adjusted in the old partners' capital accounts in their old profit-sharing ratio and the incoming partner may not be affected by the profit or loss on account of revaluation of assets and liabilities. For the purpose a revaluation account is opened.

Revaluation Account is credited with the following profit items:

a. Increase in the value of assets,
b. Decrease in the amount of liabilities and
c. Unrecorded assets now recorded.

Revaluation account is debited with the following loss items:

a. Decrease in the value of assets,
b. Increase in the amount of liabilities,
c. Unrecorded liabilities now recorded and
d. Creation of a new liability.

The balance of Revaluation account shows the net effect on account of revaluation which is transferred to old partners' capital accounts in their old profit-sharing ratio. The assets and liabilities appear in the Balance Sheet of the reconstituted firm at their revised values.

Format of Revaluation Account

Dr. **Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Assets (Individually) - (Decrease in the value) To Liabilities (Increase in the amount, unrecorded and newly created) To Partners' capital A/c (Profit on revaluation)	xxx xxx xxx	By Assets (Individually) (Increase in the value and unrecorded) By Liabilities (Decrease in the amount) By Partner's Capital A/c (Loss on revaluation)	xxx xxx xxx
	xxx		xxx

Illustration 1:

Sekhar and Sudha are partners in a firm sharing profits and losses in the ratio of 3:2 as on 31st March 2021. Their Balance Sheet was as under:

Balance Sheet

Liabilities	₹	Assets	₹
Creditors	90,000	Cash	5,000
Bills payable	25,000	Bank	40,000
Capital Accounts:		Stock	60,000
Sekhar: 1,50,000		Furniture	20,000
Sudha: 1,20,000	270,000	Land and Building	
		Debtors 62,000	
		Less: Provision	
		for Bad debts 2,000	60,000
	385,000		385,000

On 1st April 2021, they admit Sumanth into partnership on the following condition:

1. Solomon has brought Rs.1,00,000 as capital.

2. The value of land and building was to be increased by Rs.20,000.

3. Stock and furniture were to be depreciated by Rs.10,000 and Rs.5,000 respectively.

4. Rs.15,000 to be written off from Sundry creditors as it is no longer liability.

5. Provision for doubtful debts is to be increased by Rs.1,000.

Prepare Revaluation Account and the Balance Sheet.

Solution:

Dr **Revaluation Account** **Cr**

Particulars	₹	Particulars	₹
To Stock	10,000	By Land and Building	20,000
To Furniture	4,000	By Sundry Creditors	15,000
To Provision for doubtful debts	1,000		
To Profit on revaluation transferred to Sekhar's Capital A/c 12,000 Sudha's Capital A/c 8,000	20,000		
	35,000		35,000

Capital Accounts

Particulars	Sekhar	Sudha	Sumanth	Particulars	Sekhar	Sudha	Sumanth
To balance c/d	162,000	128,000	100,000	By balance b/d	150,000	120,000	100,000
				By revaluation a/c	12,000	8,000	
	162,000	128,000	100,000		162,000	128,000	100,000
				By balance b/d	162,000	128,000	100,000

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Balance c/d	1,40,000
To Sumanth's Capital A/c	1,00,000		
	1,40,000		1,40,000

Balance Sheet of Sekhar, Sudha and Sumanth

Liabilities	₹	Assets	₹
Sundry Creditors	75,000	Cash	5,000
Bills payable	25,000	Bank	140,000
Capital Accounts		Stock	50000
Sekhar : 1,62,000		Land and Building	220000

Sudha : 1,28,000 Sumanth : 1,00,000	390,000	Sundry Debtors 62,000 Less: Provision for doubtful debts 3,000 Furniture	 59000 16000
	490000		49000

Illustration 2:

Amar and Akbar are partners in a firm sharing profits and losses in the ratio of 2:1 as on 31st March 2022. Their Balance Sheet was as under:

Balance Sheet

Liabilities	₹	Assets	₹
Sundry Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	70,000
Capital Accounts		Stock	80,000
Amar : 270,000		Plant and Machinery	100,000
Akbar : 210,000		Sundry Debtors	40,000
	480,000	Land and Buildings	300,000
	600,000		600,000

On 1st April 2022, they admit Antony into partnership on the following conditions:

1. Antony has bring in a capital of Rs.1,50,000 for 1/5th share of the future profits.
2. Stock and machinery were to be depreciated by Rs.6,000 and Rs.15,000 respectively.
3. Investments of Rs.15,000 not recorded in the books brought into accounts.
4. Provision for doubtful debts is to be created at 5% on debtors.
5. A liability of Rs.4,000 for outstanding repairs has been omitted to be recorded in the books.

 Prepare Revaluation Account, Capital Account, Bank Account and the Balance Sheet.

Revaluation Account

Particulars	₹	Particulars	₹
To Stock	6,000	By Investments	15,000
To Machinery	15,000	By Loss on revaluation	12,000
To Provision for doubtful debts	2,000	transferred to:	

To Provision for outstanding repairs	4,000	Amar's Capital A/c	8,000	
		Akbar's Capital A/c	4,000	
	27,000			27,000

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	70,000	By Balance c/d	220,000
To Antony's Capital A/c	1,50,000		
	220,000		220,000

Capital's Accounts

Particulars	Amar	Akbar	Antony	Particulars	Amar	Akbar	Antony
To revaluation a/c	8,000	4,000		By balance b/d	270,000	210,000	
To balance c/d	262,000	206,000	100,000	By Bank a/c			150,000
	270,000	210,000	100,000		270,000	210,000	150,000
				By balance b/d	262,000	206,000	150,000

Balance Sheet of Amar, Akbar and Antony as on 1st April, 2022

Liabilities	₹	Assets		₹
Sundry Creditors	80,000	Cash		10,000
Bills payable	40,000	Bank		2,20,000
Outstanding repairs	4,000	Investments		15,000
Capital Accounts:		Sundry Debtors	40,000	
Amar : 2,62,000		Less: Provision		
Akbar : 2,06,000		for doubtful debts	2,000	38,000
Antony : 1,50,000	6,18,000	Plant and Machinery		85,000
		Land and Building		3,00,000
	7,42,000			7,42,000

2.3. Accounting Treatment of Goodwill: The new partner acquires his/her share profit from the existing partners. This will result in the reduction of the share of existing partners. Therefore, he/she compensates the existing partners for the sacrifices. He/she compensates them by making payment in cash or in kind. The payment is equal to his/her share in the goodwill.

If, he/she does not pay for goodwill, then amount equal to his/her share of goodwill will be deducted from the capital. The amount brought in by him/ her as goodwill or amount of goodwill deducted from his/her capital and divided between the existing partners in their sacrificing ratio. At the time of admission of a new partner any goodwill appearing in the books, will be written off in existing ratio among the existing partners.

There are different situations relating to treatment of goodwill at the time of admission of a new partner. These are discussed as under:

a. When the amount of goodwill is paid privately by the new partner.
b. When the new partner brings his/her share of goodwill in cash.
c. When the new partner does not bring his/her share of goodwill in cash.

a. The amount of goodwill is paid privately by the new partner: If the amount of goodwill is paid by the new partner to the existing partner privately, no journal entries are made in the books of the firm.

b. The new partner brings his/her share of goodwill in cash and the amount of goodwill is retained in the Business: When, the new partner brings his/her share of goodwill in cash. The amount brought in by the new partner is transferred to the existing partner in the sacrificing ratio. If there is any goodwill account in the balance sheet of existing partner, it will be written off immediately in existing ratio among the partners. The journal entries are as follows:

i) The existing goodwill in the books of the firm will be written off in existing profit ratio as:

Existing Partners Capital A/c	Dr. [individually]
To Goodwill A/c	
(Existing goodwill written off)	

ii) For bringing cash for Capital and goodwill:

Cash/Bank A/c	Dr.
To Goodwill A/c	
To New partner’s Capital A/c	

(Cash brought in for capital and goodwill)

iii) For amount of goodwill transferred to existing partner capital account:

Goodwill A/c Dr.
To Existing Partner's Capital/current A/c [individually]

(The amount of goodwill credited to existing partner's capitals in sacrificing ratio)

iv) **The amount of goodwill is withdrawn by the existing partners**:

Existing Partners Capital/current A/c Dr. [individually]
To Cash/Bank A/c

(The amount of goodwill withdrawn by the existing partners)

c. New partner does not bring his/her share of goodwill in cash: When the goodwill of the firm is calculated and the new partner is not able to bring his/her share of goodwill in cash, goodwill will be adjusted through new partner's capital accounts. In this case new partner's capital account is debited for his/her share of goodwill and the existing partner's capital accounts are credited in their sacrificing ratio. The journal entry is as under:

New Partner's Capital A/c Dr.
To Existing Partner's Capital A/c [individually in sacrificing ratio]

(New partner's share in goodwill credited to existing partner's in sacrificing ratio)

Goodwill appears in the books of the firm and new partner does not bring his/her share of goodwill in cash: If the goodwill account appears in the books of the firm, and the new partner is not able to bring goodwill in cash. In this case, the amount of goodwill existing in the books is written off by debiting the capital account of existing partners in their existing profit-sharing ratio.

New partner brings in only a part of his share of goodwill: When new partner is not able to bring the full amount of his/her share of goodwill in cash and brings only a part of cash. In this case, the amount of goodwill brought by him is credited to goodwill account. At the time of goodwill transferred to capital account of existing partner's, new partner's capital account is debited with his unpaid share of goodwill besides debiting goodwill account with the amount of goodwill is paid by him.

The journal entries is as:

Bank A/c Dr.
To Goodwill A/c
(Part Amount of goodwill brought by new partner)

Goodwill A/c Dr.
New Partner's Capital A/c Dr.
To Existing Partner's Capital A/c [individually in sacrificing ratio]
(Credit given to sacrificing partner by new partners in full share of goodwill)

2.4. Adjustment Of Partner's Capital: Sometime, at the time of admission, the partners agree that their capitals be adjusted in proportion to their profit-sharing ratio. For this purpose, the capital accounts of the existing partners are prepared, making all adjustments, on account of goodwill, general-reserve, revaluation of assets and resettlement of liabilities. The actual capital so adjust will be compared with the amount of capital that should be kept in the business after the admission of the new partner. The excess if any, of adjusted actual capital over the proportionate capital will either be withdrawn or transferred to current account and vice versa. The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit-sharing ratio or on the basis of the existing partner's capital account balances.

Adjustment of existing partner's capital on the basis of the capital of the new partner: If the capital of the new partner is given, the entire capital of the new firm will be determined on the basis of the new partner's capital and his profit-sharing ratio. Therefore, the capital of other partners is ascertained by dividing the total capital as per his profit-sharing ratio. If the existing capital of the partner after adjustment is in excess of his new capital, the excess amount is withdrawn by partner or transferred to the credit of his current account. If the existing capital of the partner is less than his new capital, the partner brings the short amount or makes transfer to the debit of his current account.

The journal entries are made as under:

i) When excess amount is withdrawn by the partner or transferred to current account.

Existing Partner's Capital A/c Dr.

To Bank A/c or Partner Current A/c

(Excess amount is withdrawn by the partner or transferred to current account)

ii) For bringing in the Deficit amount or Balance transferred to current account.

Bank A/c or Partner Current A/c Dr.

To Existing Partner's Capital A/c

(Bringing the Deficit amount or Balance transferred to current account)

Illustrations 1:

Govind and Gopal are sharing the profit in 3:2 ratio. The balance sheet of their partnership firm appears as under.

The partners propose to Admit Govardhan with a share of 3/8 in the profit of the firm from 1.04.2019. The incoming partner will bring Rs.3,00,000 as capital besides Rs.85,000 as his share of good will, in which will remain in business.

Balance Sheet of Govind and Gopal as on 31-03-2019

Liabilities	₹	Assets	₹
Capital		Cash	7,100
Govind 3,40,500		Bank	1,19,250
Gopal 3,40,500	6,81,000	Sundry Debtors	55,000
Sundry Creditors	1,24,350	Stock	1,80,000
		Furniture	44,000
		Buildings	4,00,000
	8,05,350		8,05,350

Govind and Gopal want to make the following adjustment in the books before admitting Govardhan.

1. Stock and furniture should be depreciated by 12.5 percent respectively.
2. Buildings to be raised in value of Rs.75,000.
3. A provision for bad debts to be credited with 5 percent of Sundry debtors.

4. An investment not recorded earlier in the books worth Rs.21,500 should be brought into books.
5. A contingent liability worth Rs.6,000 became a certain liability. Write necessary journal entries, prepare important accounts and show the balance sheet of the firm after Govardhan admission.

Solution:

Revaluation Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Stock Account	22,500	By Building Account	75,000
To Furniture Account	2,200	By Investment Account	21,500
To Provision for bad debt.	2,750		
To Liability Account	6,000		
To Govind's Capital A/c.	37,830		
To Gopal's Capital A/c.	25,220		
	96,500		96,500

Govind's Capital Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Balance c/d	4,29,330	By Balance b/d	3,78,330
		By Goodwill A/c	51,000
	4,29,330		4,29,330
		By Balance b/d	4,29,330

Gopal's Capital Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Balance c/d	3,99,720	By Balance b/d	3,65,720
		By Goodwill A/c	34,000
	3,99,720		3,99,720
		By Balance b/d	3,99,720

Goodwill Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Govind A/c	51,000	By Cash Account	85,000
To Gopal's Capital A/c	34,000		

	85,000		85,000

Cash Account

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Balance b/d To Goodwill A/c To Govardhan Capital A/c	7,100 85,000 3,00,000	By Balance b/d	3,92,100
	3,92,100	By Balance b/d	3,92,100

Balance Sheet of M/s. Govind, Gopal and Govardhan as on 01-04-2019

Liabilities	**₹**	**Assets**	**₹**
Sundry Creditors	1,24,350	Cash	3,92,100
Contingency Liability	6,000	Bank	1,19,250
Capital Accounts:		Sundry Debtors 55,000	
Govind 4,29,330		Less: Res. for bad debt 2,750	52,250
Gopal 3,99,720		Stock (1,80,000-22,5000)	1,57,500
Govardhan 3,00,000	11,29,050	Furniture (44,000-2,200)	41,800
		Investments	21,500
		Buildings (4,00,000+75,000)	4,75,000
	12,59,400		12,59,400

Illustration: 2

When the Goodwill is overvalued in the books of the old firm: (When Goodwill is shown at value greater than its present value in the books.)

Land M were partners in a firm sharing profit and losses in the ratio of 3:2. The balance sheet of the firm as on 31-12-2018 was as follows

Liabilities	**₹**	**Assets**	**₹**
Sundry Creditors	20,000	Cash in hand	1,00,000
Outstanding expenses	2,000	Stock	50,000

Bills payable	18,000	Sundry Debtors	25,000
Reserve fund	10,000	Bills receivable	1,00,000
Capitals:		Land & Buildings	1,00,000
L 3,00,000	11,29,050	Plant and Machinery	1,25,000
M 2,00,000	5,00,000	Good will	50,000
	5,50,000		5,50,000

On 1-1-2019 Mr. N is to be admitted on the following terms and conditions.

a. N is to bring Rs.2,00,000 for 1/4th sharing in the profits.

b. The firm's assets as to be revalued as follows.

Land & Building is to be brought to Rs.1,80,000/-

Plant & Machinery is to be reduced by 210%

R.D.D. is to be created @ 10% on Sundry Debtors.

Stock is to be reduced by 20%

Goodwill is to be revalued at Rs.35,000/-.

c. The outstanding expenditure is need not be paid.

Show Revaluations Account, Partners Capital accounts, Goodwill Account and the Balance sheet after the admission of 'N'.

Solution:

Dr. Revaluation Account Cr.

Particulars	**₹**	**Particulars**	**₹**
To Plant and Machinery A/c	12,500	By Land & Buildings	80,000
To Res. For D's Debt A/c	2,500	By Outstanding Expenses	2,000
To Stock A/c	10,000		
To L's Capital A/c 34,200			
To M's Capital A/c 22,800			
To (Profit on Revaluation transferred to Capital A/c in 3:2 ratio)	57,000		
	82,000		82,000

Dr. Goodwill Account Cr.

Particulars	₹	Particulars	₹
To balance b/d	50,000	By L's Capital A/c (3/5 X 15000)	9,000
		By M's Capital A/c (2/5 X 5000)	6,000
		By Balance c/d	35,000
	50,000		50,000

Note: Revaluation of Overvalued goodwill or undervalued goodwill of the old firm is concerned only to the old partners, hence to be debited or credited (as the case may be) only to old partners' Capital Account in old ratio.

Capital Accounts

Particulars	L ₹	M ₹	N ₹	Particulars	L ₹	M ₹	N ₹
To Goodwill A/c	9,000	6,000		By bank a/c	300,000	200,000	200,000
				By Bal b/d			
To Balance c/d	331,200	220,800	200,000	By Res. Fund A/c	6,000	4,000	
				By Revaluation A/c	34,200	22,800	
	340,200	226,800	200,000		340,200	226,800	200,000
				By Balance b/d	331,200	220,800	200,000

Balance sheet of L, M and N as on 1-1-2019

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		20,000	Cash in hand		3,00,000
Bills payable		18,000	(1,00,00+2,00,000)		
Capital A/c's;			Stock	50,000	
L's Capital	3,31,200		Less : Depreciation	10,000	40,000
M's Capital	2,20,800		Sundry Debtors	25,000	
N's Capital	2,00,000	7,52,000	Less : RBD	2,500	22,500
			Bills Receivables		1,00,000
			Land & Building	1,00,000	
			Add: Appr.	80,000	1,80,000
			Plant & Machinery	1,25,000	
			Less : Depreciation	12,500	1,12,500
			Goodwill		35,000
		7,90,000			7,90,000

6.0. Retirement of a Partner: According to section 32(1) of the Indian Partnership Act 1932, a partner may retire from the firm

a. With the consent of all the partners.
b. In accordance with an express agreement by the partners.
c. Where the partnership at will by giving notice in writing to all the other partners of his intention to retire.

Sometimes, a partner may decide to retire from the firm because of old age, ill health etc. Technically, on retirement, the old partnership comes to an end and a new one comes into existence with the remaining partners. However, the firm as such continues. A person who is retired from the firm is known as an outgoing partner or a retiring partner. A retiring partner will be held liable for the debts incurred by the firm before his retirement. But, he will not be responsible for the firms' acts after his retirement.

When a partner retires, his share in the properties of the firm has to be ascertained and paid off. Certain adjustments have to be made in the books to ascertain the amount due to him from the firm. These adjustments are very similar to those which we saw in connection with the admission of a partner.

Accounting Treatment (Adjustments)

When a partner retires, the following accounting adjustments are necessary:

a) Calculation of New profit-sharing ratio and Gaining ratio.
b) Revaluation of assets and liabilities.
c) Transfer of Undistributed Profit or loss.
d) Transfer of Accumulated reserves.
e) Treatment of Goodwill.
f) Settlement of the retiring partner's claim.

a) **Calculation of New Profit-sharing ratio and Gaining ratio:** At the time of retirement of a partner, the remaining partners acquire some portion of the retiring partner's share of profit. This necessitates the calculation of new profit-sharing ratio of the remaining partners.

New Profit-Sharing Ratio:

The ratio in which the continuing partners decide to share the future profits and losses is known as new profit-sharing ratio.

New Profit-sharing ratio = Old ratio + Gaining ratio

New share = Old share + Acquired share (gain)

Gaining Ratio:

The ratio in which the continuing partners acquire the outgoing partner's share is called as gaining ratio. This ratio is calculated by taking out the difference between new profit-sharing ratio and old profit-sharing ratio.

Gaining ratio = New ratio – Old ratio

Gain = New share – Old share

The purpose of this ratio is to determine the amount of compensation to be paid by each of the remaining partners as the firm to the retiring partner.

b) **Revaluation of Assets and Liabilities:** At the time of retirement of a partner, it is necessary to revalue the assets and liabilities of the firm. It is necessary that the retiring partner is given a share of all profits that have arisen till his retirement. Further, he is made to bear his share of losses that had occurred till his retirement. A Revaluation account is opened and credited with all the profit items and debited with all the loss items. The profit or loss on revaluation will be transferred to partners' capital accounts including the retiring partner in the old profit-sharing ratio.

c) **Transfer of Undistributed Profit or Loss:** At the time of retirement of a partner, undistributed profit or loss of the old firm should be transferred to all partners' capital accounts in their old profit-sharing ratio.

d) **Transfer of Accumulated Reserve:** Any amount kept aside as Reserve, General reserve, Reserve fund, contingency reserve etc., at the time of retirement of a partner, should be transferred to the capital accounts of all partners including retiring partner in the old profit-sharing ratio.

e) **Treatment of Goodwill:** At the time of retirement of a partner, adjustment for goodwill of the firm, if any, has to be made as in admission. In retirement too, we confine to the Revaluation Method only.

i) Goodwill is raised in the books of the firm: At the time of retirement, Goodwill is raised to its present value and brought into record. The entry is**:**

Goodwill A/c Dr ....
To All partners' capital A/c ....
(Goodwill raised and adjusted to the all-partners' capital account)

ii) Goodwill appears in the books -understated: If the goodwill appears in the balance sheet at a value less than the present value of goodwill, the difference in the goodwill account is transferred to all partners' capital accounts in the old ratio. The entry is:

Goodwill A/c Dr ....
To All Partners' capital A/c ....
(Increase in the value of goodwill transferred to all partners' capital accounts in the old ratio)

iii) Goodwill appears in the books - overstated: If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the difference in the goodwill is transferred to all partners in the old ratio. The entry is:

All Partners' Capital A/c Dr ....
To Goodwill A/c ....
(Decrease in the value of goodwill transferred to all partners' capital accounts in the old ratio)

f) Settlement of Claim of the Retiring Partner: The retiring partner is entitled for the amount due to him from the firm. The amount due to the retiring partner is ascertained by preparing his capital account incorporating all the adjustments like the share of goodwill, undistributed profits or losses, accumulated reserves, profit or loss on revaluation of assets and liabilities etc. The amount due is either paid off immediately or is paid in instalments. When it is not paid immediately, it will be transferred to his loan account.

Illustration 3:

Easwar, Fathima and Guna are partners sharing profit in the ratio of 3 : 2 : l. Their balance sheet as on December 31st 2018 is as under:

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		32,000	Cash in hand		750
Bills payable		62,500	Cash at bank		2,04,500
Capital A/c's;			Sundry Debtors		89,000
Easwar	200,000		Stock		1,11,500
Fathima	125,000		Furniture		17,500
Guna	150,000	4,75,000	Plant and Machinery		48,750
Profit & Loss A/c		22,000	Building		1,20,000
Outstanding expenses		500			
		5,92,000			5,92,000

Easwar retired from the partnership on 1st Jan, 2019 on the following terms:

1. Goodwill of the firm was to be valued at Rs.30,000
2. The assets are to be valued as under: Stock Rs.1,00,000; Furniture Rs.15,000; Plant and Machinery Rs.45,000; Building Rs.1,00,000.
3. A provision for doubtful debts be created at Rs.4,250. 4. Lalitha was to be paid off immediately.

Prepare revaluation account, capital accounts, Bank account and balance sheet of the reconstituted partnership.

Revaluation Account

Particulars	₹	Particulars	₹
To Furniture A/c	2,500	By loss transferred to Capital A/c's:	
To Plant & Machinery A/c	3,750	Easwar 15,750	
To Stock A/c	11,500	Fathima 10,500	
To Provision for bad debts A/c	4,250	Guna 15,750	42,000
To Buildings	20,000		
	42,000		42,000

Capital Accounts

Particulars	Easwar	Fathima	Guna	Particulars	Easwar	Fathima	Guna
To revaluation a/c	15,750	10,500	15,750	By balance b/d	200,000	125,000	150,000
To cash a/c	203,750			By P & L a/c	8,250	5,500	8,250
To balance c/d		127,500	153,750	By goodwill a/c	11,250	7,500	11,250
	219,500	138,000	169,500		219,500	138,000	169,500
				By balance b/d		127,500	153,750

Bank Account

Particulars	**₹**	**Particulars**	**₹**
To Balance b/d	204,500	By Lalitha Capital A/c	203,750
		By Balance c/d	750
	204,500		204,500

Balance Sheet of Fathima and Guna as on 1st April, 2019

Liabilities	**₹**	**₹**	**Assets**	**₹**	**₹**
Sundry Creditors		62,500	Cash		750
Bills payable		32,000	Bank		750
Outstanding expenses		500	Stock		1,00,000
Capital Accounts:			Sundry Debtors	89,000	
Jyothi	127,500		Less: Provision		
Kanaka	153,750	2,81,250	for doubtful debts	4250	84,750
			Plant and Machinery		45,000
			Furniture		15,000
			Land and Building		1,00,000
			Goodwill		30,000
		3,76,250			3,76,250

Illustration 4:

A, B and C were carrying a business in partnership sharing profits and losses in the ration of 3:2:1. On 31st December 2020, Balance Sheet of the firm stood as follows.

Balance Sheet

Liabilities	**₹**	**Assets**	**₹**
Sundry Creditors	13,500	Cash	5,900
Capital Accounts		Debtors	8,000
A 15,000		Stock	11,690
B 10,000		Buildings	12,000
C 10,000	35,000	Plant and Machinery	10,000
General Reserve	12,000	Furniture	2,000
	60,590		60,590

B retired on the above-mentioned date on the following terms.

i. Buildings be appreciated by Rs.7,000

ii. Provision for bad debts be made @ 5% on debtors

iii. Goodwill of the firm raised at Rs.9000 and immediately written off.

iv. Rs.5,000 be paid to B immediately and the balance due to him be treated as loan carrying interest 6% per annum.

Prepare revaluation account, Partners capital account and new Balance Sheet.

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To P.D.D	400	By Building A/c	7,000
To Profit	6,600		
(Transfer to Partners)	7,000		7,000

Dr. A's Capital Account Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c	6,750	By Balance b/d	15,000
To Balance c/d	22,050	By Goodwill a/c	4,500
		By Revaluation a/c	3,300
		By General reserve a/c	6,000
	28,800		28,800
		By Balance b/d	22,050

Dr. B's Capital Account Cr.

Particulars	₹	Particulars	₹
To Cash a/c	5,000	By Balance b/d	10,000
To Loan A/c	14,200	By Goodwill a/c	3,000
		By Revaluation a/c	2,200
		By General reserve a/c	4,000
	19,200		19,200

Dr. C's Capital Account Cr.

Particulars	₹	Particulars	₹
To Goodwill A/c	2,250	By Balance b/d	10,000
To Balance c/d	12,350	By Goodwill a/c	1,500
		By Revaluation a/c	1,100
		By General reserve a/c	2,000
	14,600		14,600
		By Balance b/d	14,600

Balance Sheet of A & C as on 01-01-2021

Liabilities	₹	Assets	₹
Sundry Creditors	13,590	Cash 5,900	
Capital Accounts		Less : B's Cap. 5,000	900
A 22,050		Debtors 8,000	
C 12,350	34,400	Less: P.D.D 400	7,600
B's Loan A/c	14,200	Stock	11,690
		Building 23,000	
		+ App. 7,000	30,000
		Plant & Machinery	10,000
		Furniture	2,000
	62,190		62,190

Short Answer Questions (2 Marks)

1. What is Partnership Business?
2. What do you mean by Goodwill?
3. Manjula and Kusuma started business on 1st April 2018 with capitals of Rs.60,000 and Rs. 50,000 respectively. On 1st July 2018 Manjula withdrew Rs.8,000 from his capital. Kusuma introduced additional capital Rs.10,000 on 30.9.2018. Calculate interest on capital at 5% for the year ending 31st March 2019.

   (Answer: Interest on capital; Manjula: ₹ 2,700; Kusuma: ₹ 2,750)
4. P, Q and R had capitals of Rs. 80,000, Rs.60,000 and Rs.40,000 respectively on 1.4.2017. Q withdrew Rs.8,000 from his capital on 30.9.2017, King introduced additional capital Rs. 12,000 on 31.12.2017. Calculate interest on capital at 6% for the year ending 31st March 2018.

   (Answer: Interest on capital; P: ₹ 4,800; Q : ₹ 3,360; R : ₹ 2,580)

5. The profit for the five years of a firm are as follows: 2014 – Rs. 400000; 2015 – Rs. 398000; 2016 – Rs. 450000; 2017 –Rs. 445000; 2018 – Rs. 500000. Calculate goodwill of the firm on the basis of 4 years purchase of 5 years average profits.
 (Ans: ₹ 17,54,400)
6. A firm earns profit of Rs. 65000 on a capital of Rs. 480000 and the normal rate of return in similar business is 10%. 3 years purchase value of super profit will be treated as goodwill. **(Ans: ₹ 51000)**
7. Goodwill is to be valued at three years purchase of five year's average profits. The profits for the last five years of the firm were: 2012 - Rs. 4,200; 2013 - Rs. 4,500; 2014 - Rs. 4,700; 2015 - Rs. 4,600 and 2016 - Rs. 5,000. **(Ans.: Goodwill ₹ 13,800)**
8. Calculate the amount of goodwill on the basis of two year's purchase of the last four years average profits. The profits for the last four year's are: I Year Loss ₹ 10,000 II Year Profit ₹ 26,000 III Year Profit ₹ 34,000 IV Year Profit ₹ 50,000
 (Ans.: Goodwill ₹ 50,000)
9. Goodwill is to be valued at three years purchase of four years average profits. The profits for the last four years of the firm were: 2001 - Rs. 12,000; 2002 - Rs. 18,000; 2003 - Rs. 16,000; 2004 - Rs. 14,000. Calculate the amount of goodwill.
 (Ans.: Goodwill ₹ 45,000)
10. Calculate the amount of goodwill on the basis of two years' purchase of the last four years' average profits. The profits of the last four years are 2014 Profit Rs. 20,000; 2015 Profit Rs. 30,000; 2016 Loss Rs. 6,000; 2017 Profit Rs. 16,000.
 (Ans.: Goodwill ₹ 30,000)
11. A firm earned net profits during the last three years as follows: I Year ₹ 36,000 II Year ₹ 40,000 III Year ₹ 44,000 The Capital investment of the firm is ₹1,20,000. A fair return on the capital having regard to the risk involved is 10%. Calculate the value of goodwill on the basis of three years purchase of Super profits.
 (Ans.: Goodwill ₹ 84,000)
12. A firm earned average profit during the last few years is Rs. 40000 and the normal rate of return in similar business is 10%. The total assets is Rs. 360000 and outside liabilities is Rs. 50000. Calculate the value of goodwill with the help of Capitalisation of Average Profit Method. **(Ans: ₹ 90,000)**
13. A business has earned average profits of Rs. 1,00,000 during the last few years and the normal rate of return in a similar business is 10%. Ascertain the value of

goodwill by Capitalisation average profits method, given that the value of net assets of the business is Rs. 8,20,000. **(Ans: ₹180000)**

14. Mani and Nani are partners sharing profit and losses in the 1:2 ratio. They have decided to admit 'Omkar' by giving him 1/4th share in future profits. Calculate the New Profit-Sharing Ratio. **(Ans: 1:2:1)**
15. Padma and Rani are partners sharing the ratio of 2:3. They admit Ratna for 1/4h share and she gets this share equally from Padma and Rani. Calculate new ratio. **(Ans: 11:19:15)**
16. James and Roi are partners sharing in the ratio of 4:3. They admit Jhansi with 3/7th share; which he gets 2/7th from James and 1/7th from Roi. What is the new profit-sharing ratio? **(Ans: 2:2:3)**
17. Anitha and Bhanu are partners sharing in the ratio of 3:2. Chandu is admitted and he gets 3/20th from Anitha and 1/20th from Bhanu. Calculate new ratio. **(Ans: 9:7:4)**
18. Srikanth and Gopi are partners share profits in the ratio of 5:3. Madhu the new partner gets 1/5th of Srikanth's share and 1/3rd of Gopi's share. Calculate new ratio. **(Ans: 4:2:2)**
19. If Satya and Siri are partners sharing profits in the ratio of 5:3. What will be their sacrificing ratio, if Revathi is admitted for 1/8th share of profit in the firm? **(Ans: 5:3)**
20. Krishna and Balram are partners in a firm sharing profits in the ratio of 5:2. They admitted Arjun as a new partner for 1/4th share. The new profit-sharing ratio of the partners will be 2:1:1. Calculate their sacrificing ratio. **(Ans: 6:1)**

Exercises (6 Marks)

1. Tripathi and Chauhan are partners in a firm sharing profits and losses in the ratio of 3:2. Their capitals were Rs.60,000 and Rs.40,000 as on January 01, 2005. During the year they earned a profit of Rs. 30,000. According to the partnership deed both the partners are entitled to Rs. 1,000 per month as Salary and 5% interest on their capital. They are also to be charged an interest of 5% on their drawings, irrespective of the period, which is Rs. 12,000 for Tripathi, Rs. 8,000 for Chauhan. Prepare Partner's Accounts when, capitals are fixed.

   (Ans: Tripathi's Current account Balance ₹ 20,400, Chauhan's Current account Balance ₹ 17,600).

2. Anushka and Kajal are partners of a firm sharing profits and losses in the ratio of 2:1. Their capital, were Rs.90,000 and Rs.60,000. The profit during the year were Rs. 45,000. According to partnership deed, both partners are allowed salary, Rs. 700 per month to Anushka and Rs. 500 per month to Kajal. Interest allowed on capital @ 5%p.a. The drawings at the end of the period were Rs. 8,500 for Anushka and Rs. 6,500 for Kajal. Interest is to be charged @ 5% p.a. on drawings. Prepare partners' capital accounts, assuming that the capital account are fluctuating.

(Ans: Anushka's Capital Account Balance ₹ 1 ,23,975, Kajal's Capital Account Balance ₹ 77, 175).

3. Rakhi and Shikha are partners in a firm, with capitals of ₹ 2,00,000 and ₹ 3,00,000 respectively. The profit of the firm, for the year ended 2016-17 is ₹ 23,200. As per the Partnership agreement, they share the profit in their capital ratio, after allowing a salary of ₹ 5,000 per month to Shikha and interest on Partner's capital at the rate of 10% p.a. During the year Rakhi withdrew ₹ 7,000 and Shikha ₹10,000 for their personal use. You are required to prepare Profit and Loss Appropriation Account and Partner's Capital Accounts.

(Ans: Loss Transferred to Rakhi Capital ₹ 34, 720 and Shikha Capital ₹ 52,080)

4. Lokesh and Azad are partners sharing profits in the ratio 3:2, with capitals of ₹ 50,000 and 30,000, respectively. Interest on capital is agreed to be paid@ 6% p.a. Azad is allowed a salary of ₹ 2,500 p.a. During 2016, the profits prior to the calculation of interest on capital but after charging Azad's salary ₹ 12,500. A provision of 5% of profits is to be made in respect of manager's commission. Prepare accounts showing the allocation of profits and partner's capital accounts.

(Ans: Profit transferred to Lokesh's Capital ₹ 4,170 and Azad's Capital ₹ 2,780)

5. The partnership agreement between Maneesh and Girish provides that:

a. Profits will be shared equally;
b. Maneesh will be allowed a salary of Rs. 400 p.m.;
c. Girish who manages the sales department will be allowed a commission equal to 10% of the net profits, after allowing Maneesh's salary;
d. 7% interest will be allowed on partner's fixed capital;
e. 5% interest will be charged on partner's annual drawings;

f. The fixed capitals of Maneesh and Girish are Rs. 1,00,000 and Rs. 80,000, respectively. Their annual drawings were Rs. 16,000 and 14,000, respectively. The net profit for the year ending March 31 , 2018 amounted to Rs. 40,000; Prepare firm's Profit and Loss Appropriation Account.
(Ans: Profit transferred to the Capital accounts of Maneesh and Girish, ₹ 1 0,290)

6. Ram, Raj and George are partners sharing profits in the ratio 5 : 3: 2. According to the partnership agreement George is to get a minimum amount of Rs. 10,000 as his share of profits every year. The net profit for the year 2018 amounted to Rs, 40,000. Prepare the Profit and Loss Appropriation Account.
(Ans: Profit transferred to Ram's Capital ₹ 18,750 Raj's Capital ₹ 11,250 and George 'Capital ₹ 1 0 ,000)

7. Anwar, Bhatia and Suresh are partners in a firm. Their profit-sharing ratio is 2:2:1. Suresh is guaranteed a minimum amount of ₹ 10,000 as share of profit, every year. Any deficiency on that account shall be met by Bhatia. The profits for two years ending December 31, 2017 and December 31, 2018 were ₹ 40,000 and ₹ 60,000, respectively. Prepare the Profit and Loss Appropriation Account for the two years.
(Ans: For the year 2017, Profits transferred to Anwar's Capital, ₹ 16,000; Bhatia's Capital ₹ 14,000; Suresh's capital ₹ 10,000 and for the year 2018, Profit transferred to Anwar's Capital ₹ 24,000, Bhatia's Capital ₹ 24,000, Suresh's capital ₹ 12,000)

8. Ramesh and Suresh were partners in a firm sharing profits in the ratio of their capitals contributed on commencement of business which were ₹ 80,000 and ₹ 60,000 respectively. The firm started business on April 1, 2018. According to the partnership agreement, interest on capital and drawings are 12% and 10% p.a., respectively. Ramesh and Suresh are to get a monthly salary of ₹ 2,000 and ₹3,000, respectively. The profits for year ended March 31, 2019 before making above appropriations was ₹ 1,00,300. The drawings of Ramesh and Suresh were ₹ 40,000 and ₹ 50,000, respectively. Interest on drawings amounted to ₹ 2,000 for Ramesh and ₹ 2,500 for Suresh. Prepare Profit and Loss Appropriation Account and partners' capital accounts, assuming that their capitals are fluctuating.

(Ans: Profit transferred to Ramesh's Capital ₹ 16,000 and Suresh's Capital, ₹ 12,000)

Admission Of a Partner

Exercises (6 Marks)

1. Amir and Basha are carrying on business in a partnership, sharing profit & Losses in the ratio of 2:3. Their Balance sheet as at 31-3-2019 was as under.

Balance Sheet

Liabilities		₹	Assets	₹
Sundry Creditors		50,000	Cash in hand	30,000
Capital Accounts			Cash at Bank	20,000
Amir	2,80,000		Sundry Debtors	1,00,000
Basha	4,20,000	7,00,000	Stock	2,00,000
			Furniture	50,000
			Buildings	3,50,000
		7,50,000		7,50,000

On that date they admit 'Soheil' in to partnership and given him 1/4th share in the future profit on the following terms:

(a) 'Soheil' is to bring in Rs.3,00,000 as his Capital and Rs.1,00,000 as good will, which sum is to remain in the business.

(b) Stock and Furniture are to be reduced in value by 10%

(c) Buildings are to be appreciated by Rs. 50,000

(d) A provision of 5% to be created on sundry Debtors for doubtful debts.

Prepare Revaluation Account and show the opening Balance Sheet of the new firm.

(Balance Sheet ₹ 11,70,000, Revaluation profit ₹ 20,000)

2. The Balance Sheet of Srinitha & Srihitha who are partners sharing profit & losses in the ratio 2:1 on 31-03-2021 was as under.

Balance Sheet

Liabilities		₹	Assets		₹
Sundry Creditors		1,00,000	Cash		5,000
Bills payable		3,20,000	Sundry Debtors	4,00,000	
			Less:		
			Provision for D.	5,000	3,95,000
General Reserve		1,80,000	Stock		2,50,000
Capitals			Furniture		1.00.000
Srinitha	3,00,000		Buildings		3,00,000
Srihitha	1,50,000	4,50,000			
		10,50,000			10,50,000

On that date Srinidhi was admitted for 1/3 share of profit on the following terms

(a) That Srinidhi brings in Cash Rs.90,000 for Goodwill & Rs.1,50,000 as Capital.
(b) That half of the goodwill shall be withdrawn by the old partners.
(c) The provision for bad and doubtful debts is to be increased by Rs.10,000.
(d) That a liability for Rs.8,500 be created against outstanding salaries.
(e) That the stock & Furniture to reduce by 5%.
(f) That the value of Buildings be appreciated by 10%.

Prepare Revaluation a/c, Partners Capital Account & Balance Sheet of new firm.

(Balance Sheet ₹ 12,47,500, Revaluation Loss ₹ 6,000)

3. Naveen and Kiran are partners sharing their profits in the ratio of 3:2 on 31-12-2021. The Balance Sheet is as under:

Balance Sheet

Liabilities		₹	Assets	₹
Creditors		16,000	Cash in hand	2,000
Bank O.D.		10,000	Cash in Bank	10,000
Bills Payable		12,000	Debtors	20,000
Capitals A/cs:			Stock	18,000
Naveen	48,000		Furniture	10,000
Kiran	24,000	72,000	Buildings	30,000
			Machinery	20,000
		1,10,000		1,10,000

Adjustments:

Rajesh was admitted as partner in the following conditions.

(a) Firm's Goodwill valued for Rs.10,000
(b) Depreciate stock, furniture, machinery @ 10%
(c) Appreciate Buildings @ 10%
(d) Provide Reserve for Bad Debts at 5% on the debtors.
(e) Rajesh has to brings Rs.16,000/- in cash for his share of Capital.

Prepare necessary accounts & the new balance sheet of the firm after Rajesh's entry.

(Ans: Revaluation loss ₹ 2,800; Capital A/C Balance – Naveen ₹ 52,320; Kiran ₹ 26,880; Rajesh ₹ 16,000 B/s Total ₹ 1,33,200.

4. X, Y Share profit in the ratio of 1:1. Their Balance Sheet as on 31-12-2021 is given below.

Liabilities	**₹**	**Assets**	**₹**
Outstanding expenses	10,000	Cash in hand	4,000
Creditors	48,000	Cash at Bank	38,000
Overdrafts	40,000	Debtors	40,000
Bills payable	20,000	Furniture	12,000
Capital Accounts		Buildings	57,000
X 45,000		Machinery	42,000
Y 30,000			
	1,93,000		1,93,000

They admitted Z on the following conditions.

(a) Depreciations on Machinery, Buildings, Furniture by 5%

(b) Provision for bad debts 5% on debtors.

(c) Create Goodwill Rs.30,000

(d) She Should bring Rs.45,000/- as capital for 1/4th Share.

Prepare profit & loss Adjustment account & New Balance Sheet on 1.1.22

(Ans: Revaluations Loss ₹ 7,550; Capital Balance X-₹ 56,225; Y- ₹ 41,225; Z - ₹ 45,000; B/s Total ₹ 2,60,450)

5. Given below is the Balance Sheet of A and B who are carrying on a partnership business as on 31-12-2021. A and B share profit and Losses in the ratio of 2:1.

Balance Sheet

Liabilities	**₹**	**Assets**	**₹**
Bills payable	10,000	Cash in hand	10,000
Creditors	58,000	Cash at Bank	40,000
Outstanding	2,000	Sundry Debtors	60,000
Capitals A/cs:		Stock	40,000
A 1,80,000		Plant and Machinery	1,00,000
B 1,50,000	3,30,000	Buildings	1,50,000
	4,00,000		4,00,000

‘C’ is admitted as a partner on the date if the Balance Sheet is on the following terms.

(a) ‘C’ will brings in Rs.1,00,000 as his capital & Rs.60,000 as his share of Goodwill for ¼ share of profit.

(b) Plant and Machinery is to be appreciate to Rs.20,000 & the value of Building is to be appreciated by 10%.

(c) Stock is found overvalued by Rs.4,000.

(d) A provision for bad & doubtful debts is to be created at 5% on debtors.

(e) Creditors were unrecorded to the extent of Rs.1,000/-.

Prepare the Profit & Loss adjustment account and show the Balance Sheet after the admission of ‘C’.

(Ans: Revaluation profit ₹ 27,000; Capital Account Balances A- ₹ 2,38,000; B- ₹ 1,79,000; C- ₹ 1,00,000; Balance Sheet Total ₹ 5,88,000)

Retirement of a Partner

1. X,Y,Z were partners sharing profits in the ratio of ½, 1/6, 1/3, Their Balance Sheet on 31-12-2021was as follows:

Liabilities	₹	Assets		₹
Sundry Creditors	20,500	Buildings		50,000
Bills Payable	10,000	Plant and Machinery		25,000
Capital Accounts		Furniture		2,500
X 15,000		Stock		22,500
Y 10,000		Debtors	20,000	
Z 10,000	80,000	Reserve	1,000	19,000
Reserve fund	12,000	Cash		3,500
	1,22,500			1,22,500

Z retires, so the following adjustment were agreed upon for ascertainment of the payment be made to him.

(1) Appreciate the Buildings by 10% and Stock by 15%.

(2) Depreciate Plant by 10% and furniture by 7 ½ %.

(3) Reserve for Doubtful debts to be made up to Rs.1,500.

(4) Create Goodwill worth Rs.20,000.

(5) The amount payable should be transferred to Loan account.

(6) It is assumed that goodwill credited to retiring partner is being reduced from X and Y‘s Capital Balance Sheet.

(Ans: Revaluation Profit – Rs.5,187; Z's Loan A/c – Rs.47,39, Balance Sheet Total – Rs.1,27,687)

2. A, B, C are sharing profits and losses in the ration of 5:3:2 on 31st December, 2021. The balance sheet was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	21,000	Cash	50,500
Bills Payable	10,000	Debtors 31,000	
General Reserve	20,000	(-) Res.for b. debt 500	30,500
Capital Accounts		Stock	20,000
A 80,000		Machinery	40,000
B 60,000		Building	80,000
C 30,000	1,70,000		
	2,21,000		2,21,000

On 1st January, 2022 C retired on the following terms

1. Value of buildings to be appreciated by 10%.
2. Bad debts reserve to be increased to Rs. 1,200.
3. Goodwill is to be created Rs.40,000.
4. Amount due to C is to be transferred to 8% loan account in her name.

(Ans. Revaluation Profit – ₹ 7,300; C's 8% Loan A/c – ₹ 43,460 Balance Sheet Total ₹ 2,68,300)

3. Gayatri, Chandrika and Padma are partners sharing profit and losses in the ratio of 5:3:2. Their Balance Sheet as on 31.12.2018 is given below.

Liabilities	₹	Assets	₹
Sundry Creditors	1,21,000	Buildings	80,000
Bills Payable	10,000	Machinery	1,40,000
Capital Accounts		Stock	20,000
Gayatri 80,000		Debtors 31,000	
Chandrika 60,000		Reserve 500	19,000
Padma 30,000	1,70,000	Cash	50,500
Reserve fund	20,000		1,22,500

	3,21,000		3,21,000

Padma retires on the following adjustments.

(1) Appreciate Buildings by 10% and depreciate Machinery by 20% and stock revalued at ₹15,000.

(2) Bad debts reserve is to be increased up to ₹1,200

(3) Goodwill is to be created for ₹ 49,000.

Prepare profit and loss adjustment account and new balance sheet.

(Ans: Revaluation's Loss – ₹ 25,700: Padma Loan A/c – ₹ 39,660; Balance Sheet total – ₹ 3,44,300).

4. Navaratna, Revathi and Konda are partners sharing profits and losses equally. Their Balance Sheet on 31st March 2021 is given below.

Liabilities		₹	Assets	₹
Sundry Creditors		20,000	Cash & Bank	18,000
Reserve fund		18,000	Debtors	30,000
Capital Accounts			Stock	24,000
Navaratna	50,000		Machinery	40,000
Revathi	40,000		Buildings	46,000
Konda	30,000	1,20,000		
		1,58,000		1,58,000

On the above date, Konda decided to retire from the firm on the following conditions.

(i) Goodwill of the firm be valued at ₹ 24,000.

(ii) Depreciate stock & Machinery by 10%

(iii) Buildings will be appreciated to ₹ 56,000.

(iv) Provide 5% on the debtors towards reserve for doubtful debts.

Write Revaluations Account, Capital Account and Balance Sheet after due amount is to be paid in cash to Konda to the extent possible and Balance transferred to a Loan A/C.

(Ans: Revaluation's profit – ₹ 2,100; Konda Loan A/c – ₹ 26,700; Balance sheet – Rs.1,66,100)

5. Shanti, Indu and Lakshmi are partners sharing profit and losses equally. Their Balance Sheet as on 31st March, 2018 is given below.

Liabilities	₹	**Assets**	₹
Sundry Creditors	1,00,000	Cash & Bank	90,000
Profit & Loss A/c	90,000	Debtors	1,50,000
Capital Accounts		Stock	1,20,000
Shanti 2,50,000		Machinery	2,00,000
Indu 2,00,000		Buildings	2,30000
Lakshmi 1,50,000	6,00,000		
	7,90,000		7,90,000

On above date Lakshmi, decided to retire from the firm on the following conditions:

(a) Goodwill of the firm to be valued at ₹1,20,000.

(b) Depreciate stock and Machinery by 10%

(c) Buildings to be appreciated up to ₹ 2,80,000.

(d) Provide 5% on debtors towards reserve for doubtful debts.

Prepare ledger accounts and new balance sheet of the firm as on 1.4.2018.

(Balance sheet Total ₹ 9,20,500, Revaluation profit ₹ 10,500)

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UNIT – VII
COMPANY ACCOUNTS

Meaning of company – Meaning of Share capital – Classification of share capital – Types of shares – Issue of shares at par, premium, discount – Journal Entries.

Learning Objectives

After studying this unit, the student will be able to

- Understand the meaning of company and share capital
- Understand about classification of share capital
- Learn about classification of shares
- Issue of shares.

1.0. Definition of Company: According to Justice Marshall a company is 'an artificial being invisible, intangible and existing only in the contemplation of Law. "According to Sec. 3(1) of the Companies Act defines a company as 'company formed and registered under this Act, or an existing company'. An existing company means a company formed and registered under any of the former companies Acts.

1.1. Meaning of Share Capital: A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. These persons are known as shareholders and the amount contributed by them is called share capital. Since the number of shareholders is very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called as 'Share Capital Account'.

1.2. Categories Of Share Capital: From accounting point of view the share capital of the company can be classified as follows:

1. **Authorized Capital:** Authorised capital is the amount of share capital which a company is Authorised to issue by its Memorandum of Association. The company cannot raise more than the amount of capital as specified in the Memorandum of Association. It is also called Nominal or Registered capital.

The Authorised capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company need not issue the entire Authorised capital for public subscription at a time. Depending upon its requirement, it may issue share capital but, in any case, it should not be more than the amount of Authorised capital.

2. **Issued Capital:** It is that part of the Authorised capital which is actually issued to the public for subscription including the shares allotted to vendors and the signatories to the company's memorandum. The Authorised capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.
3. **Subscribed Capital:** It is that part of the issued capital which has been actually subscribed by the public. When the shares offered for public subscription are subscribed fully by the public the issued capital and subscribed capital would be the same. It may be noted that ultimately, the subscribed capital and issued capital are the same because if the number of shares, subscribed is less than what is offered, the company allot only the number of shares for which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer. In other words, the fact of over subscription is not reflected in the books.
4. **Called-up Capital:** It is that part of the subscribed capital which has been called up on the shares. The company may decide to call the entire amount or part of the face value of the shares. For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called-up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.
5. **Paid-up Capital:** It is that portion of the called-up capital which has been actually received from the shareholders. When the shareholders have paid all the call amount, the called-up capital is the same to the paid-up capital. If any of the shareholders has not paid amount on calls, such an amount may be called as 'calls in arrears. Therefore, paid-up capital is equal to the called-up capital minus call-in-arrears.

6. **Uncalled Capital:** That portion of the subscribed capital which has not yet been called-up. As stated earlier, the company may collect this amount any time when it needs further funds.
7. **Reserve Capital:** A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company. Such uncalled amount is called 'Reserve Capital' of the company. It is available only for the creditors on winding up of the company.

1.3. Nature And Classes of Shares: Shares, as applied to the capital of a company, refer to the units into which the total share capital of a company is divided. Thus, a share is a fractional part of the share capital and forms the basis of ownership interest in a company. The persons who contribute money through shares are called shareholders.

The amount of Authorised capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company's capital is to be divided, along with their respective rights and obligations, are prescribed by the Articles of Association of the company. As per Section 86 of The Companies Act, a company can issue two types of shares. They are:

a. Preference shares, and

b. Equity shares (also called ordinary shares).

a. Preference Shares: According to Section 85 of The Companies Act, 1956, a preference share is one, which fulfils the following conditions:

i) That it carries a preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

ii) That with respect to capital it carries or will carry, on the winding-up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders.

However, notwithstanding the above two conditions, a holder of the preference share may have a right to participate fully or to a limited extent in the surpluses of the company as specified in the Memorandum or Articles of the company. Thus, the preference shares can be participating and non-participating. Similarly, these shares can be cumulative or non-cumulative, and redeemable or irredeemable.

b. Equity Shares: According to Section 85 of The Companies Act, 1956, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preference shareholders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the number of profits available for distribution. The equity share capital may be

i) With voting rights; or

ii) With differential rights as to voting, dividend or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

1.3.1. Distinction between Preference Shares and Equity Shares:

Preference Shares	Equity Shares
1. Preference Dividend is paid before paying any dividend on equity shares.	1. Equity shareholders will get dividend only after paying dividend to preference shareholders.
2. At the time of liquidation after payment of creditors, preference shares are redeemed before equity shares.	2. Equity shares are repaid after full repayment is made on preference shares.
3. The rate of dividend is fixed.	3. Rate of dividend is not fixed; it may vary from year to year.
4.In case of preference shares (cumulative preference shares) arrears of dividends will accumulate.	4. There is no question of accumulation of arrears of dividend.

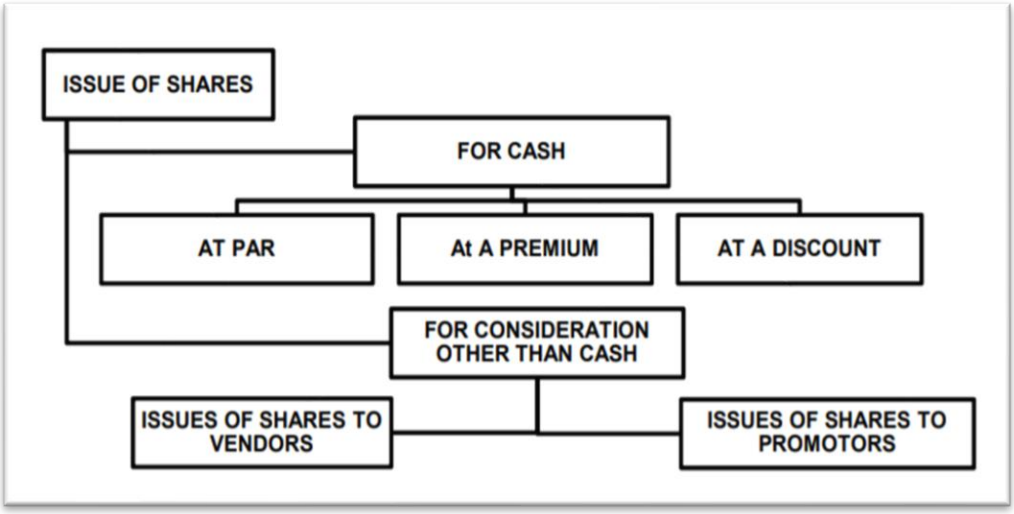
5. Preference shares (convertible pref. shares) can be converted into equity shares.	5. Equity shares cannot be converted into preference shares.
6. Preference shareholders do not have voting rights unless their rights are affected.	6. Equity shareholders have voting right.
7. Redeemable preference share are redeemable according to the provision of Sec 80A of the Companies Act.	7. There is no provision for redemption of equity shares.

1.4. Issue Of Shares: A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over a period of time depending upon its growing financial requirement. The first installment is collected along with application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining instalment are termed as first call, second call and so on. The word final is suffixed to the last installment. However, this in no way prevents a company from calling the full amount on shares right at the time of application.

The important steps in the procedure of share issue are:

- **Issue of Prospectus:** The Company first issues the prospectus to the public. Prospectus is an invitation to the public that a new company has come into existence and it needs funds for doing business. It contains complete information about the company and the manner in which the money is to be collected from the prospective investors.
- **Receipt of Applications:** When prospectus is issued to the public, prospective investors intending to subscribe the share capital of the company would make an application along with the application money and deposit the same with a scheduled bank as specified in the prospectus. The company has to get minimum subscription (Refer Box 1) within 120 days from the date of the issue of the prospectus. If the company fails to receive the same within the staid period, the company cannot proceed for the allotment of shares and application money should be returned within 130 days of the date of issue of prospectus.

- **Allotment of Shares:** If minimum subscription has been received, the company may proceed for the allotment of shares after fulfilling certain other legal formalities. Letters of allotment are sent to those whom the shares have been allotted, and letters of regret to those to whom no allotment has been more. When allotment is made, it results in a valid contract between the company and the applicants who now became the shareholders of the company.



1.5. Accounting For Share Capital: Shares of a company are issued either at par, at a premium or at a discount. Shares are said to have been issued at par when their issue price is exactly equal to their nominal value according to the terms and conditions of issue. When the shares of a company are issued more than its nominal value (face value), the excess amount is called premium and the issue is said to have been made at a premium. When the shares are issued at a price less than the face value of the share, it is known as shares issued at a discount. Irrespective of the fact that shares are issued at par, premium or discount, the share capital of a company as stated earlier, is collected in instalments to be paid at different stages.

1.5.1. Accounting Treatment:

<u>**Issue of Shares at Par Value:**</u>

i) On application: The amount of money paid with various installments represents the contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially individual accounts are opened for each instalment. All money received along with application is deposited with a scheduled bank in a separate account opened for the purpose. The journal entry is as follows:

Bank A/c Dr.

To Share Application A/c

(Amount received on application for — shares @ Rs. ______ per share).

ii) **On allotment:** When minimum subscription has been received and certain legal formalities on the allotment of shares have been duly complied with, the directors of the company proceed to make the allotment of shares. The allotment of shares implies a contract between the company and the applicants who now become the allottees and assume the status of share-holders or members.

The journal entries with regard to allotment of shares are as follows:

1. For Transfer of Application Money:

   Share Application A/c Dr.

   To Share Capital A/c

   (Application money on ______ Shares allotted/ transferred to Share Capital)

2. For Money refunded on rejected application:

   Share Application A/c Dr.

   To Bank A/c

   (Application money returned on rejected application for — shares).

3. For Amount Due on Allotment:

   Share Allotment A/c Dr.

   To Share Capital A/c

   (Money due on allotment of _______ shares @ Rs. per share).

4. For Adjustment of Excess Application Money:

   Share Application A/c Dr.

   To Share Allotment A/c

   (Application Amount on — Shares @ Rs. per shares adjusted to the amount due on allotment).

5. For Receipt of Allotment Amount:

   Bank A/c Dr.

   To Share Allotment A/c

(Allotment money received on — Shares @ Rs. — per share Combined Account)

Sometimes a combined account for share application and share allotment called 'Share Application and Allotment Account' is opened in the books of a company. The combined account is based on the reasoning that allotment without application is impossible while application without allotment is meaningless. These two stages of share capital are closely inter-related.

When a combined account is maintained, journal entries are recorded in the following manner:

1. For Receipt of Application and Allotment:
   Bank A/c Dr.
   To Share Application and Allotment A/c
   (Money received on applications for shares @ Rs. _____ per share).
2. For Transfer of Application Money and Allotment Amount Due:
   Share Application and Allotment A/c Dr.
   To Share Capital A/c
   (Transfer of application money to Share Capital Account for amount due or allotment of — Share @ Rs. _____ per share).
3. For Money Refunded on Rejected Applications:
   Share Application and Allotment A/c Dr.
   To Bank A/c
   (Application money returned on rejected application for ___ shares).
4. On Receipt of Allotment AmountL:
   Bank A/c Dr.
   To Share Application and Allotment A/c
   (Balance of Allotment Money Received).

iii) On Calls: Calls play a vital role in making shares fully paid-up and for realising the full number of shares from the shareholders. In the event of shares not being fully called-up till the completion of allotment, the directors have the authority to ask for the remaining amount on shares as and when they decide about the same. It is also possible that the timing of the payment of calls by the shareholders is determined at the time of share issue itself and given in the prospectus.

Two points are important regarding the calls on shares. First, the amount on any call should not exceed 25% of the face value of shares. Second, there must be an interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.

When a call is made and the amount of the same is received, the journal entries are as given below:

1. For Call Amount Due:

   Share Call A/c Dr.

   To Share Capital A/c

   (Call money due on — Shares @ Rs. ____ per share)

2. For Receipt of Call Amount:

   Bank A/c Dr.

   To Share Call A/c

   (Call money received).

The word/words First, Second, or Third must be added between the words "Share" and 'Call' in the Share Call account depending upon the identity of the call made. For example, in case of first call it will be termed as 'Share First Call Account', in case of second call it will be 'Share Second Call Account' and so on. Another point to be noted is that the words 'and Final' will also be added to the last call, say, if second call is the last call it will be termed as 'Second and Final Call' and if it is the third call which is the last call, it will be termed as 'Third and Final Call'. It is also possible that the whole balance after allotment may be collected in one call only. In that case the first call itself shall be termed as the 'First and Final Call'.

The following points should be kept in mind while issuing the share capital for public subscription:

1. The application money should be at least 5% of the face value of the share.
2. Calls are to be made as per the provisions of the articles of association.
3. Where there is no Articles of Association of its own, the following provisions of Table A will apply:

(a) A period of one month must elapse between two calls;
(b) The amount of call should not exceed 25% of the face value of the share;
(c) A minimum of 14 days' notice is given to the shareholders to pay the amount; and
(d) Calls must be made on a uniform basis on all shares within the same class.

Note: The procedure for accounting for the issue of both equity and preference shares is the same. To differentiate between the two the words 'Equity' and 'Preference' is prefixed to each and every instalment.

Illustration 1: Mona Earth Mover Ltd. decided to issue 12,000 shares of Rs.100 each payable at Rs.30 on application, Rs.40 on allotment, Rs.20 on first call and balance on second and final call. Applications are received for 13,000 shares. The directors decided to reject application of 1,000 shares and their application money being refunded in full. The allotment money is duly received on all the shares, and all sums due on calls are received except on 100 shares.

Record the transactions in the books of Mona Earth Movers Ltd.

Journal Entries in the Books of Mona Earth Movers Limited

Date	Particulars	L.F. No.	Debit ₹	Credit ₹
	Bank A/c Dr.		3,90,000	
	To Share Application A/c			3,90,000
	(Application money on 13,000 shares @ ₹ 30 per share received).			
	Share Application A/c Dr.		3,90,000	
	To Share Capital A/c			3,90,000
	(Application money transferred to share capital).			
	Share Allotment A/c Dr.		4,80,000	
	To Share Capital A/c			4,80,000
	(Money due on allotment of 12,000 shares @ ₹ 40 per share).			

	Share Application A/c Dr. To Bank A/c (Application money on 1,000 shares returned).		30,000	 30,000
	Bank A/c Dr. To Share Allotment A/c (Money received on 12,000 shares @ ₹ 40 per share on allotment).		4,80,000	 4,80,000
	Share First Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ ₹ 20 per share on first Call).		2,40,000	 2,40,000
	 Bank A/c Dr. To Share First Call A/c (First Call money received except for 100 shares).		2,38,000	 2,38,000
	 Share Second and Final Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ ₹ 10 per share on Second and final Call).		1,20,000	 1,20,000
	Bank A/c Dr. To Share Second and Final Call A/c (Second and final call money received except for 100 shares).		1,19,000	 1,19,000

Illustration 2: Eastern Company Ltd. issued 40,000 shares of Rs. 10 each to the public for the subscription of its share capital, payable at Rs. 4 on application, Rs. 3 on allotment and the balance on Ist and final call. Applications were received for 40,000 shares. The company made the allotment to the applicants in full. All the amounts due on allotment and first and final call were duly received. Give the journal entries in the books of the company.

Journal |Entries in the Books of Eastern Company Limited

Date	Particulars	L.F. No.	Debit ₹	Credit ₹
	Bank A/c Dr.		160,000	
	To Share Application A/c			160,000
	(Application money on 40,000 shares @ ₹ 4 per share received).			
	Share Application A/c Dr.		160,000	
	To Share Capital A/c			160,000
	(Application money transferred to share capital).			
	Share Allotment A/c Dr.		120,000	
	To Share Capital A/c			120,000
	(Money due on allotment of 40,000 shares @ ₹ 3 per share).			
	Bank A/c Dr.		120,000	
	To Share Allotment A/c			120,000
	(Money received on 40,000 shares @ ₹ 3 per share on allotment).			
	Share First and Final Call A/c Dr.		120,000	
	To Share Capital A/c			120,000
	(Money due on 40000 shares @ ₹ 3 per share on First and final Call).			
	Bank A/c Dr.		120,000	
	To Share First and Final Call A/c			120,000
	(First and final call money received)			

Issue of Shares at a Premium: It is quite common for the shares of financially strong and well-managed companies to be issued at a premium, i.e., at an amount more than the nominal or par value of shares. Thus, when a share of the nominal value of Rs. 100 is issued at Rs. 105, it is said to have been issued at a premium of 5 percent.

When the issue of shares is at a premium, the amount of premium may technically be called at any stage of the issue of shares. However, premium is generally called with the amount due on allotment, sometimes with the application money and rarely with the call money. The premium amount is credited to a separate account called ‘Securities Premium Account’ and is shown on the liabilities side of the company’s balance sheet under the heading ‘Reserves and Surpluses’. It can be used only for the following four purposes as laid down by Section 78 of The Companies Act 1956:

a. To issue fully paid bonus shares to an extent not exceeding unissued share capital of the company;
b. To write-off preliminary expenses of the company;
c. To write-off the expenses of, or commission paid, or discount allowed on any of the shares or debentures of the company; and
d. To pay premium on the redemption of preference shares or debentures of the company. The Journal entries for shares are issued at a premium are as follows:

The Journal Entries for Shares Are Issued at A Premium Are as Follows:

1. For Premium Amount called with Application money:

   Bank A/c Dr.

   To Share Application A/c

   (Money received on application for — shares @ Rs. — per share including premium)

   Share Application A/c Dr.

   To Share Capital A/c

   To Securities Premium A/c

   (Transfer of application money to share capital and securities premium accounts)

2. Premium Amount called with Allotment Money:

   Share Allotment A/c Dr.

   To Share Capital A/c

   To Securities Premium A/c

   (Amount due on allotment of shares @ Rs — per share including premium)

   Bank A/c Dr.

To Share Allotment A/c

(Allotment money received including premium)

Illustration 3: Jupiter Company Limited issued 35,000 equity shares of Rs. 10 each at a premium of Rs.2 payable as follows: On Application Rs. 3, On Allotment Rs. 5 (including premium) Balance on First and Final Call. The issue was fully subscribed. All the money was duly received. Record journal entries in the books of Jupiter Company.

Date	Particulars	L.F. No.	Debit ₹	Credit ₹
	Bank A/c Dr.		105,000	
	To Equity Share Application A/c			105,000
	(Application money on 35,000 shares @ ₹3 per share received).			
	Share Application A/c Dr.		105,000	
	To Share Capital A/c			105,000
	(Application money transferred to share capital).			
	Share Allotment A/c Dr.		175,000	
	To Share Capital A/c			105,000
	To Security Premium A/c			70000
	(Amount due on allotment of 35,000 shares @ ₹ 5 per share including premium)			
	Bank A/c Dr.		175,000	
	To Share Allotment A/c			175,000
	(Money received including premium).			
	Share First and Final Call A/c Dr.		140,000	
	To Share Capital A/c			140,000
	(Amount due on First and Final Call of ₹ 4 per share on 35,000 shares)			
	Bank A/c Dr.		140,000	
	To Share First and Final Call A/c			140,000
	(First and final call money received)			

Issue of Shares at a Discount:

There are instances when the shares of a company are issued at a discount, i.e., at an amount less than the nominal or par value of shares, the difference between the nominal value and issue price representing discount on the issue of shares. For example, when a share of the nominal value of Rs. 100 is issued at Rs. 98, it is said to have been issued at a discount of two per cent.

As a general rule, a company cannot ordinarily issue shares at a discount. It can do so only in cases such as ‘reissue of forfeited shares’ (to be discussed later) and in accordance with the provisions of section 79 of The Companies Act.

It states that, a company is permitted to issue shares at a discount provided the following conditions are satisfied:

a. The issue of shares at a discount is Authorised by an ordinary resolution passed by the company at its general meeting and sanctioned by the Company Law Board Now Central Government.
b. The resolution must specify the maximum rate of discount at which the shares are to be issued but the rate of discount must not exceed 10 per cent of the nominal value of shares. The rate of discount can be more than 10 per cent if the Government is convinced that a higher rate is called-for under special circumstances of a case.
c. At least one year must have elapse since the date on which the company became entitled to commence the business.
d. The shares are of a class which has already been issued.
e. The shares issued within two months from the date of receiving sanction for the same from the Government or within such extended period as the Government may allow.
f. If the offer prospectus at the date of issue must mention particulars of the discount allowed on the issue of shares.

Whenever shares are issued at a discount, the amount of discount is brought into the books at the time of allotment by debiting an account called ‘Discount on the Issue of Shares Account’.

The Journal Entry to Be Passed For The Purpose Is As Given Below:

Share Allotment A/c Dr.
Discount on the Issue of Shares A/c Dr.
To Share Capital A/c
(Amount due on allotment of — shares @ Rs — per share and discount on issue brought into account.)

'Discount on the Issue of Shares Account', having a debit balance, denotes a loss to the company and is shown on the asset side of the company's balance sheet under heading 'Miscellaneous Expenditure'. It is written-off by being charging it to the Securities Premium Account if any and, in its absence, by being gradually charged to the Profit and Loss Account over a period of 5 to 10 years.

Illustration 4: Fine Arts Limited issued to the public for subscription of 10,000 shares of Rs.10 each at a discount of 10% payable at Rs. 4 on application, Rs. 3 on allotment and Rs.2 on 1st and the final call. The issue was fully subscribed and all the money was duly received. Write journal entries for the above in the books of the company.

Date	Particulars	L.F. No.	Debit ₹	Credit ₹
	Bank A/c Dr.		40,000	
	To Share Application A/c			40,000
	(Application money on 10,000 shares @ ₹ 4 per share received).			
	Share Application A/c Dr.		40,000	
	To Share Capital A/c			40,000
	(Application money transferred to share capital).			
	Share Allotment A/c Dr.		30,000	
	Discount on Issue of Share A/c Dr.		10000	
	To Share Capital A/c			40,000

	(Amount due @ ₹ 3 per share on Allotment and @ ₹ 1 per share discount on 10,000 shares allotted)			
	Bank A/c Dr.		30000	
	To Share Allotment A/c			30,000
	(Share Allotment Money received)			
	Share First and Final Call A/c Dr.		20,000	
	To Share Capital A/c			20,000
	(Final Call of ₹ 2 per share due on 10,000 shares)			
	Bank A/c Dr.		20,000	
	To Share First and Final Call A/c			20,000
	(First and final call money received)			

Short Answer Questions (2 Marks)

1. What is Share?
2. What is Authorised Share Capital?
3. What is Preference Share?
4. What is Equity Share?

Essay Type Questions (6 Marks)

1. Explain the categories of share capital?
2. Explain briefly about the procedure for issue of shares?
3. What are the main differences between Equity shares and Preference shares?

Exercises (6 Marks)

1. Anitha Limited issued 30,000 equity shares of ₹ 100 each payable at ₹ 30 on application, ₹ 50 on allotment and ₹ 20 on 1st and final call. All money was duly received.

Record these transactions in the journal of the company.

2. The Anu Control Device Ltd was registered with the authorised capital of ₹ 3, 00,000 divided into 30,000 shares of ₹ 10 each, which were offered to the public. Amount payable as ₹ 3 per share on application, ₹ 4 per share on allotment and ₹ 3 per share on first and final call. These shares were fully subscribed and all money was dully received. Prepare journal and Cash Book.

3. Sruthi ltd issued 10000 shares of ₹100 each for the subscription. Payable at ₹ 40 per share on application, ₹ 40 per share on allotment and the balance ₹ 20 on first and final call. All the amounts were duly received. Make journal entries in the books of the company.

4. Laasya ltd decided to issue 10000 shares of ₹ 200 each for the subscription. Payable at ₹ 50 per share on application, ₹ 100 per share on allotment and the balance ₹ 50 on first and final call. All the money was duly received. Write journal entries in the books of the company.

Issue of Shares at Premium:

5. Krishna Furniture's Ltd issued 20000 shares of ₹ 100 each at a premium of ₹ 10 per share payable as follows,

   On application ₹ 40 (including premium ₹ 5 per share)

   On allotment ₹ 40 (including premium ₹ 5 per share)

   The remaining balance ₹ 30 on first and final call, the issue was fully subscribed. All the money was duly received. Make the journal entries in the books of the company.

6. Siri Ltd having an Authorised capital of ₹ 100,00,000 in share of ₹ 10 each issued 10000 at a premium of ₹ 2 per share, payable at ₹ 4 on application (including premium ₹ 1 per share), ₹ 5 on allotment (including premium ₹ 1per share), the remaining balance ₹ 3 on first and final call, the issue was fully subscribed. All the money was duly received. Prepare the journal entries in the books of the company.

Issue of Shares at Discount:

7. Padmavathi Ltd issued to the public for subscription of 10000 shares of ₹ 100 each at a discount of 10% per share, payable at ₹ 30 on application, ₹ 40 on allotment and ₹ 20 on first and final call, the issue was fully subscribed. All the money was duly received. Write the journal entries in the books of the company.

8. Sai ltd issued 20000 shares of ₹ 100 each at a discount of 10% per share, the shares were payable at ₹ 40 on application, ₹ 30 on allotment and ₹ 20 on first and final call, the issue was fully subscribed. All the money was duly received. Record the journal entries in the books of the company.

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UNIT – VIII

COMPUTERISED ACCOUNTING - II

Tally – Introduction - Features/Advantages – Gateway of Tally – Company Creation - Types of Vouchers - Function Keys - Ledger Creation – Customization of Financial Reports.

Learning Objectives:

After studying this Chapter, you will be able to:

- Understand the meaning and concept of Tally Accounting Software
- Understand silent features of Tally
- Understand how to create, alter the details of Company

1. **Introduction:** Tally.is one of the most widely used financial software. Tally. Reports can help a business owner make informed decisions to increase efficiency, reduce costs, and organize business operations. With Tally, accurate, up-to-date business information is available at your fingertips anytime. It provides a Comprehensive solution for the accounting and inventory needs of a business. It provides the capability to generate fully accurate tax returns in a matter of minutes and is also capable of extracting, interpreting and presenting financial data.

Tally is the world's fastest and most powerful concurrent Multi-lingual business Accounting and Inventory Management software. Tally., designed exclusively to meet the needs of small and medium businesses, is a fully integrated, affordable and highly reliable software. Tally.is easy to buy, quick to install, and easy to learn and use.

Tally is designed to automate and integrate all your business operations, such as sales, finance, purchasing, inventory, and manufacturing. With Tally, accurate, up-to-date business information is literally at your fingertips anywhere. The powerful new features and blazing speed and power of Tally combined with enhanced MIS, Multilingual, Data Synchronization and Remote capabilities help you simplify all your business processes easily and cost-effectively.

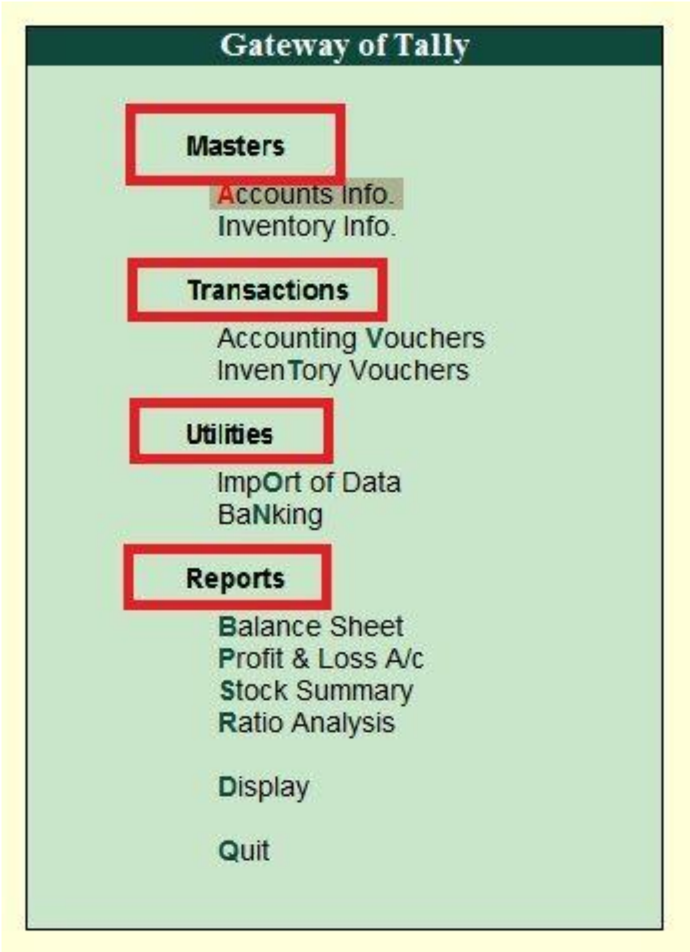
1.1. **Salient Features of Tally: A leading accounting package:** The first version of Tally was released in 1988 and, through continuous development, is now recognised as one of the leading accounting packages across the world, with over a quarter million customers. Tally’s market share is more than 90%.

a. **No accounting codes:** Unlike other computerised accounting packages which require numeric codes, Tally pioneered the ‘no accounting codes’ concept. Tally.ERP 9 users have the freedom to allocate meaningful names in plain English to their data items in the system.
b. **Complete business solution:** Tally provides a comprehensive solution to the accounting and inventory needs of a business. The package comprises financial accounting, book-keeping and inventory accounting. It also has various tools to extract, interpret and present data.
c. **Integrated/Non-integrated accounting and inventory:** With Tally, the user is able to choose to maintain accounts only. If accounting with inventory is opted for, the user can choose whether it should be integrated or not.
d. **Flexible and easy to use:** Tally is very flexible. It mimics the human thought process, which means that tally an adapt itself to any business need. Tally users need not change the way their business is run to adapt themselves to the package.
e. **Speed:** Tally Provides the capability to generate instant and accurate reports, which assist the management to take timely and correct decisions for the overall productivity and growth of the company.
f. **Power:** Tally allows the user to maintain multiple companies and with unlimited levels of classification& grouping capabilities. It also allows drill down facility from report level to transaction level.
g. **Flexibility:** Tally. provides flexibility to generate instant reports for any given period (month/year) or at any point of time besides providing the facility to toggle between Accounting & Inventory reports of the same company or between companies.
h. **Concurrent multilingual capability:** Tally offers you the exclusive capability of maintaining your accounts in any Indian language, viewing them in another language and printing them in yet another Indian language.
i. **Real time processing:** Immediate posting &updation of books of accounts as soon as the transactions are entered, thereby facilitating instant statements & Reports. It also facilitates a real-time multi-user environment.

j. **Versatility:** Tally is suitable for a range of organisations, from small grocery stores to large corporations with international locations and operations.

k. **Multi-platform availability:** Tally.is available on multiple versions of windows. It runs on a single PC or on a network. On a network, it supports access via any combination of platforms.

1.2. Gate Way of Tally:



1.3. Company Creation in Tally: To start accounting with tally the first and foremost thing you should know is, how to create company in tally ERP9. For users operating multiple business can create several companies in Tally erp 9 software at single cost. Nowadays Tally erp 9 has outgrown from the concept just an accounting software. it helps you for better statutory compliance by updating statutory files available at tally solution website. You can operate tally remotely using tally.net features, process payroll and many more features are updating regularly by tally solutions. The most recent improvement is GST. Tally erp 9 is GST compatible from version Tally erp 9 release 6.

Procedure:

i) Open Tally Software by double clicking on the Tally.ERP 9 icon.

ii) If you are opening Tally ERP 9, First time after installation, you will be landed to a menu called company info menu. (If you are in Gateway of Tally Press Alt+F3 to get that menu).

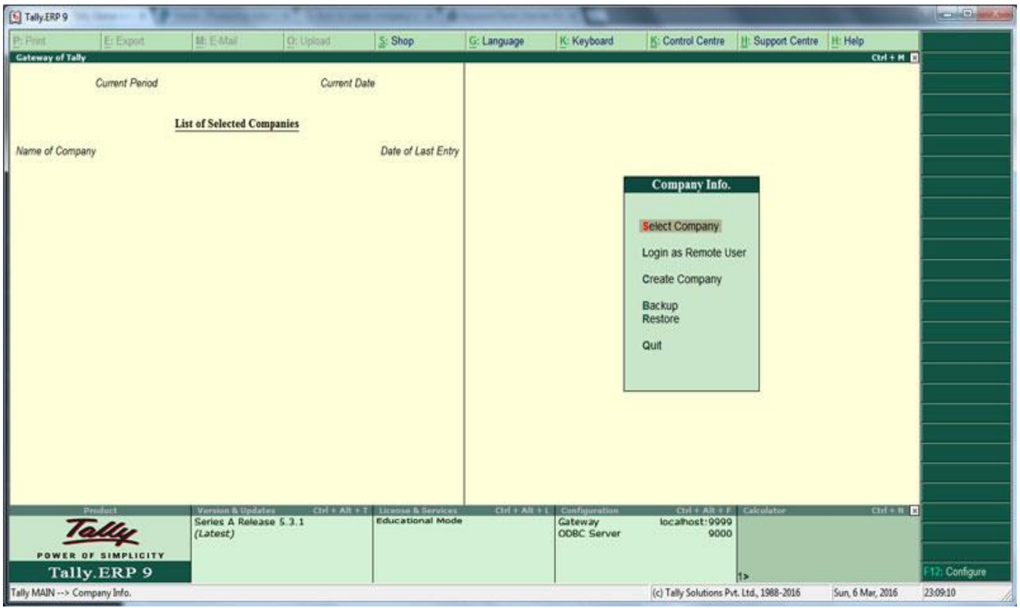
iii) Select Create Company option in the menu and press enter key.

iv) The screen displayed in-front of you is company creation screen.

v) Type the name of the company, address, financial year begins and all other details asked by the creation screen.

vi) Press Enter Key, Finally the program will ask you the confirmation to Save, Yes or No.

vii) To save and create company do Press Enter Key, Press Y Key or click on Yes. The program will create a company and you will be entered into it.



1.4. Definition of Voucher: A **voucher** is a pre-numbered document used in processing payments. This document is typically prepared by the accounts payable department after receiving the supplier's invoice. In the process, the supplier's invoice is matched with the related purchase order and receiving report to ensure that only goods received and services rendered to the company will be processed for payment. Matching these three documents prevents the company from paying incorrect and sometimes fraudulent invoices.

A voucher can be electronic, but most often, it is a manual, paper document.

1.5. Voucher Entry in Tally.ERP 9: A voucher is a document that contains details of a financial transaction and is required for recording the same into the books of accounts. For every transaction, you can use the appropriate Tally voucher to enter the details into the ledgers and update the financial position of the company.

The voucher entry menus options are available under Transactions in the Gateway of Tally. The Payroll and Order Vouchers are available as separate options which can be enabled based on the requirements.

The Payroll Vouchers can be enabled from F1: Accounting Features, whereas the Order Vouchers can be activated from F2: Inventory Features.

Note: If the company is maintained with Accounts Only Company, Inventory Vouchers option will not be displayed under Transactions.

1.6. Types of Vouchers: A voucher is a document that contains details of a financial transaction and is required for recording the same into the books of accounts. For every transaction, you can use the appropriate Tally voucher to enter the details into the ledgers and update the financial position of the company.

The voucher entry menus options are available under Transactions in the Gateway of Tally. The Payroll and Order Vouchers are available as separate options which can be enabled based on the requirements.

The Payroll Vouchers can be enabled from

F1: Accounting Features, whereas the Order Vouchers can be activated from

F2: Inventory Features.

Note: If the company is maintained with Accounts Only Company, Inventory Vouchers option will not be displayed under Transactions.

Predefined Vouchers in Tally.ERP 9: Tally comprises of the following predefined Vouchers, to suit different business requirements for recording various transactions. Tally also allows you to create user-defined Vouchers (Voucher Types) as per your requirements.

i) Contra Voucher (F4)
ii) Payment Voucher (F5)
iii) Receipt Voucher (F6)
iv) Journal voucher (F7)
v) Sales Voucher / Invoice (F8)

vi) Purchase Voucher / Invoice (F9)

vii) Debit Note Voucher (Ctrl+F9)

viii) Credit Note Voucher (Ctrl+F8)

i) **Contra Voucher:** As per the Accounting Principles, a Contra entry is a transaction involving transfer of cash between one Cash A/c to another or one Cash A/c to another Bank A/c i.e., is a transaction indicating transfer of funds from:

- Cash account to Cash account
- Cash account to Bank account
- Bank account to Cash account
- Bank account to Bank account

To view the Contra Voucher Entry Screen,

Go to Gateway of Tally > Accounting Vouchers

Select F4: Contra from the Button Bar or press F4 .

Click on the following links for more:

● Creating Contra Entry in Single Entry Mode

● Creating Contra Entry in Double Entry Mode

Note: Use the options available in the Button Bar for more additional features and navigation.

ii) **Payment Voucher:** Payment voucher is used to account all the payments made by the company by way of Cash/Bank.

Payment voucher can be passed using Single Entry or Double Entry mode by configuring the setting Use Single Entry mode for Pymt/Rcpt/Contra in F12 configuration.

iii) **Receipt Voucher:** Any money received from debtors against sales Invoices or on Account and for all transactions where money is received are accounted or entered into Tally.ERP 9 using the Receipt Voucher.

To view the Receipt Voucher screen,

☞ Go to Gateway of Tally > Accounting Vouchers.

☞ Select F6: Receipt from the button bar or press F6.

For example, if your company receives money from a customer for an earlier transaction say sales, and the same is passed through a Receipt Voucher:

- Credit the customer account and debit the Cash account, if you receive cash or
- Debit the Bank account where you need to deposit the money, if you receive Cheques.

iv) Purchase Voucher: When a company buys goods on credit or cash, Purchase voucher is used to record all the Purchase transactions of the company.

To pass a Purchase Voucher,

- Go to Gateway of Tally > Accounting Vouchers.
- Click on F9: Purchase on the Button Bar or press F9 .

For example, if you are purchasing goods from Supplier A for a value of Rs. 10000/-

- Debit Purchase Account.
- Credit Party Account.

v) Sales Voucher: Sales Voucher is used to record the Sales transactions of the company. You can pass an entry using the Voucher mode or the Invoice mode where the calculations can be automated and the transactions can be fed into the system easily.

vi) Debit Note Entry: Debit Note is a document issued to a party stating that you are debiting their Account in your Books of Accounts for the stated reason or visa versa. It is commonly used in case of Purchase Returns, Escalation/De-escalation in price, any other expenses incurred by you on behalf of the party etc.

Debit Note can be entered in voucher or Invoice mode.

You need to enable the feature in F11: Accounting or Inventory features**.**

- To use it in Voucher mode you need to enable the feature in F11: Accounting Features - Use debit and credit notes.
- To make the entry in Invoice mode enable the option F11: Accounting Features - Record debit notes in invoice mode.

vii) **Credit Note Entry:** Credit Note is a document issued to a party stating that you are crediting their Account in your Books of Accounts for the stated reason or visa versa. It is commonly used in case of Sales Returns, Escalation/De-escalation in price etc.

A Credit Note can be entered in voucher or Invoice mode.

You need to enable the feature in F11: Accounting or Inventory features.

- ☞ To use it in Voucher mode you need to enable the feature in F11: Accounting Features - Use debit and credit notes.
- ☞ To make the entry in Invoice mode enable the option F11: Accounting Features - Record credit notes in invoice mode.

1.7. Items in Voucher Screen: A voucher entry screen in Tally comprises of the following sections:

i) **Type of Voucher:** It is essential to check if you are using the right voucher for the transaction. You can change the voucher type by selecting a new type from the button bar, if required. For example, on the selection of a payment voucher, Tally automatically displays the list of voucher types you have created. You can select the voucher type required.

ii) **Voucher Number:** Tally automatically sets the voucher number for you. You can change the voucher number manually, if required.

iii) **Reference:** You can enter a reference of your choice. A purchase order number or an invoice number can be entered as a reference.

iv) **Date of Voucher:** The date of the voucher you enter is displayed at the top-right of the voucher creation screen. The date is taken initially from the Gateway of Tally - Current Date and you may need to change it frequently to ensure that the vouchers are dated as you want.

v) **Effective Date:** A voucher type can be configured to allow for an effective date. The line below the date of voucher displays the date when the voucher will be effective. This will be available only if the effective date option is activated in the particular voucher type.

vi) **Particulars:** This is where you enter the ledger names and the debit and credit amounts. Each line displays a prompt of Dr or By for debit entries and Cr or To for credit entries. Depending on the voucher type, Tally selects either ‘Dr’ or ‘Cr’ for the first prompt, which you cannot change.

Thereafter, you can change the prompt (if necessary) by typing over it with a 'D' or a 'C'. To select a ledger, type the first letter of its name.

Tally then displays a List of ledger accounts beginning with the letter highlighted. Only ledgers suitable for the voucher type are displayed. The revised current balance is shown after the amount is entered. On selecting the next ledger, Tally suggests the balancing amount as the value to be entered, which may be accepted or typed over. The voucher entry cannot be completed until the debits equal the credits.

vii) Narration: Here you type whatever appropriately describes the transaction. Remember, you can have a separate narration foreach line of particulars, if you configure the voucher type in that way. Once the narration is complete, press Enter to bring up the Accept? The box. Once you accept the data, Tally presents another voucher entry screen.

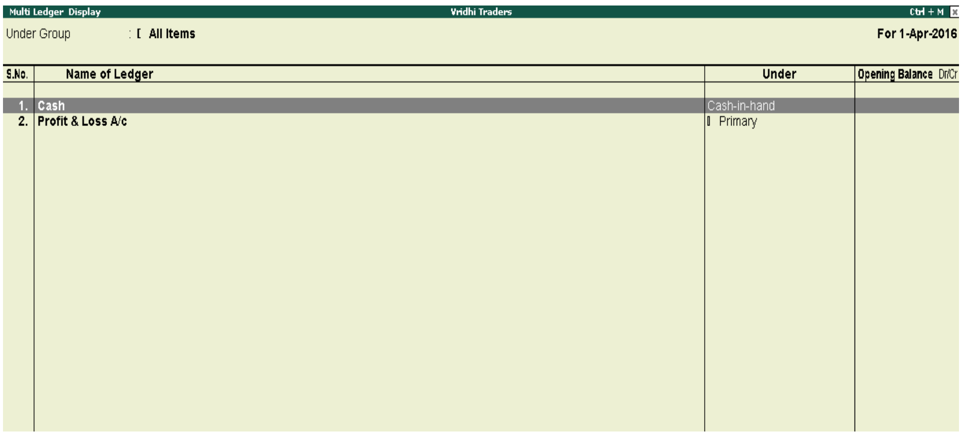
1.8. Ledgers and Groups:

i) Ledgers: A 'Ledger' is an account head. For instance, the sales account head will be called a 'Sales Ledger' i Tally.ERP 9. Similarly, a customer would be an account head, and will be called a 'party ledger'. You can create ledgers specific to your business transactions.

For a newly created company, there are two pre-defined ledgers available in Tally.ERP 9:

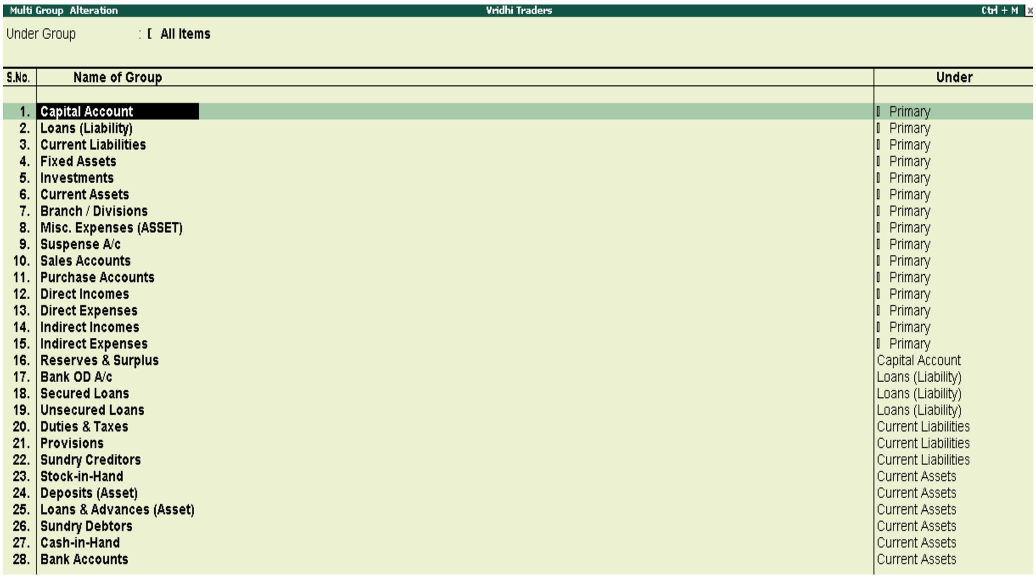
- Cash
- Profit & Loss A/c

To view the list of ledgers, go to Gateway of Tally > Accounts Info.>Ledgers > Display (Multiple Ledgers) >Select All Items. The Multi Ledger Display Screen appears in the following manner: -



ii) Groups: A ‘Group’ is the accounting group under which ledgers of the same nature can be classified. For instance, Tally. has a default Group ‘Sales Accounts’, under which all the sales ledgers will be classified. There are 28 pre-defined groups in Tally., which feature in the chart of accounts of many organisations. Out of these, 15 groups are primary groups and the remaining 13 are sub-groups.

Among the 15 primary groups, 9 groups are balance sheet items and the remaining 6 groups are Profit & Loss A/c items. You can use these groups to build your chart of accounts, as well as create and used group’s specific to your business transactions. However, you may also alter the nomenclature of these 28 groups. Maintaining Chart of Accounts in Tally.



Multi Group Alteration Vridhi Traders Ctrl + M

Under Group : All Items

S.No.	Name of Group	Under
1.	Capital Account	Primary
2.	Loans (Liability)	Primary
3.	Current Liabilities	Primary
4.	Fixed Assets	Primary
5.	Investments	Primary
6.	Current Assets	Primary
7.	Branch / Divisions	Primary
8.	Misc. Expenses (ASSET)	Primary
9.	Suspense A/c	Primary
10.	Sales Accounts	Primary
11.	Purchase Accounts	Primary
12.	Direct Incomes	Primary
13.	Direct Expenses	Primary
14.	Indirect Incomes	Primary
15.	Indirect Expenses	Primary
16.	Reserves & Surplus	Capital Account
17.	Bank OD A/c	Loans (Liability)
18.	Secured Loans	Loans (Liability)
19.	Unsecured Loans	Loans (Liability)
20.	Duties & Taxes	Current Liabilities
21.	Provisions	Current Liabilities
22.	Sundry Creditors	Current Liabilities
23.	Stock-in-Hand	Current Assets
24.	Deposits (Asset)	Current Assets
25.	Loans & Advances (Asset)	Current Assets
26.	Sundry Debtors	Current Assets
27.	Cash-in-Hand	Current Assets
28.	Bank Accounts	Current Assets

To view the list of the 28 groups, known as the List of Accounts, go to Gateway of Tally > Accounts Info. >Groups > Display (Multiple Groups) > Select All Items.

The Multi Group Display Screen appears as per Figure 1.7Figure 1.7 List of Multiple Groups Screen Out of the 15 Primary groups, the following appear in the Profit & Loss Account:

- Sales Accounts
- Purchase Accounts
- Direct Incomes or Income (Direct)
- Indirect Incomes or Income (Indirect)
- Direct Expenses or Expenses (Direct)
- Indirect Expenses or Expenses (Indirect)

1.8.1. Ledger Creation: In Tally, we can create the ledgers in two ways given below:

I. Single Ledger Creation: Here we can create one ledger at a time.

II. Multiple Ledger Creation: Here we can create different ledgers at one go and also ledgers which belong to particular group.

I. Single Ledger Creation: Creation of Proprietor's Capital Account ledger from single ledger creation screen.

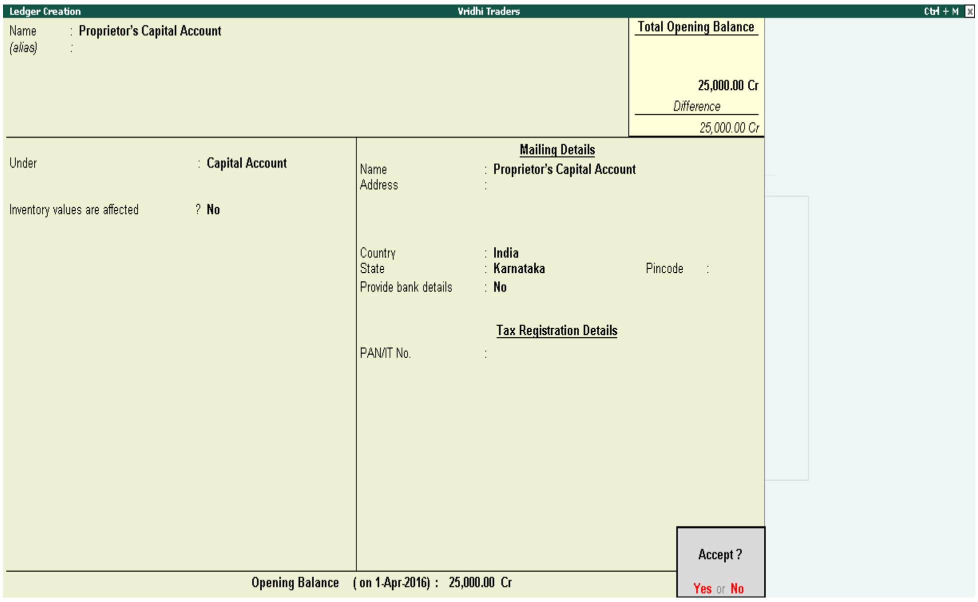
☞ Go to Gateway of Tally > Accounts Info. > Ledgers > Create (Single Ledger Creation).

☞ Enter Name as Proprietor's Capital Account

- Select Capital Account from the List of Groups. The Ledger Creation Screen appears as per below Figure.

  Ledger Creation screen — Proprietor's Capital Account

- Press Y or Enter to accept the screen. Tally displays the total debit and credit opening balances in the right upper corner of screen while the ledgers are being created in the ledger creation screen. This is to avoid differences in the opening balance.



II. Multiple Ledger Creation: Now let us create the following ledgers using the Multi Ledger Creation option: To create Multiple Ledgers at once, follow the below given steps:

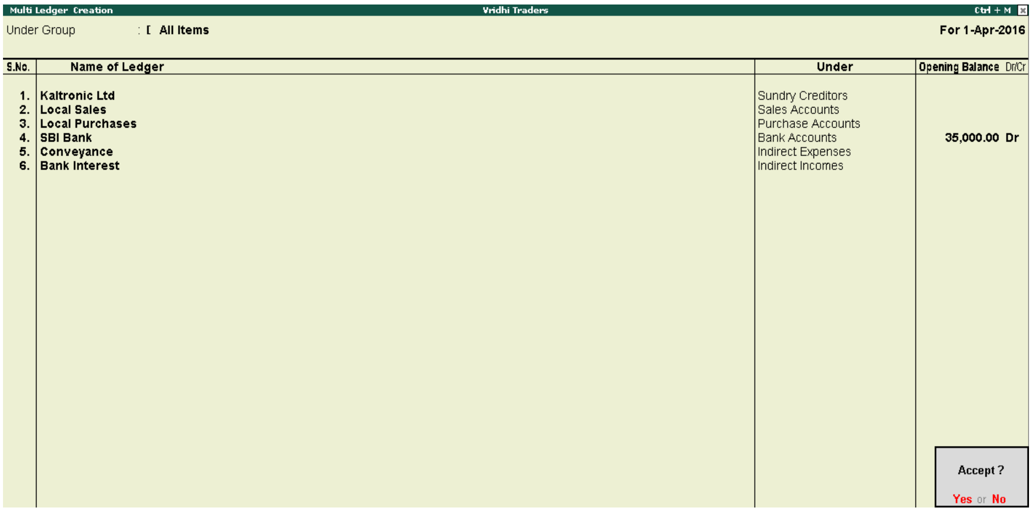
☞ Go to Gateway of Tally > Accounts Info > Ledgers > Multiple ledgers > Create

☞ From Under Group field select All Items Note.

If you select Purchase Account in the 'Under Group' field, then the ledger will be created under Purchase Account Head.

- Under Name of Ledger enter the name as Kaltronic Ltd
- Select as Sundry Creditors from the List of Groups
- Press Enter and move to next line as there is no opening balance
- Similarly, select the other ledgers as shown below. Press Enter or Y to Accept Multi Ledger Creation Screen

Now that we have learnt how to create ledgers under Tally default pre-defined groups, let us move on to understand how to make alterations to ledgers that are already created.



1.8.2. Group Creation: In Tally., there are 28 predefined groups, this mean that it is not necessary to create the Account Group in Tally. However, considering the different requirement of an organisation and its nature, Tally provided flexibility to create the account group. There are two ways of creating groups:

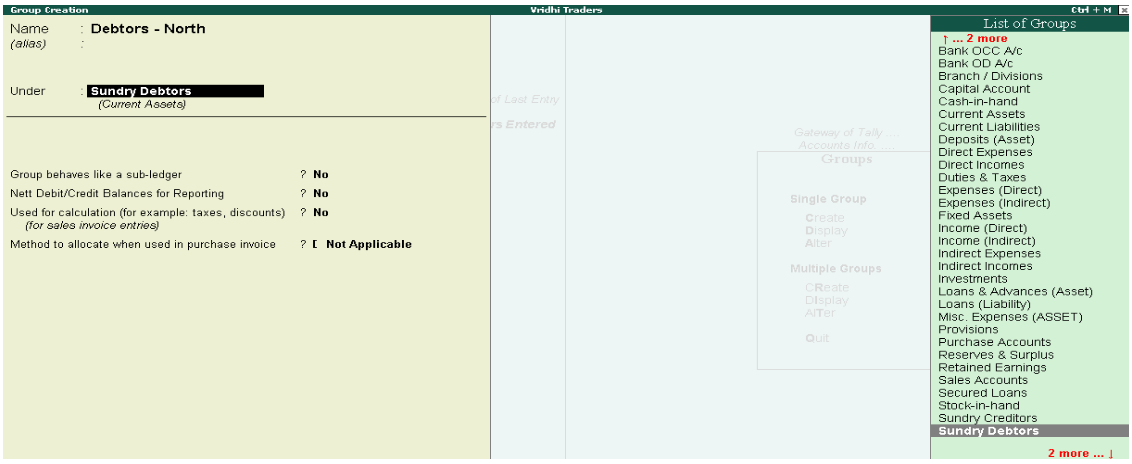
I. Single Group Creation: It Involves creation of a single group at a time.

II. Multiple Group Creation: It Involves creation of multiple groups at a time.

- Go to Gateway of Tally > Accounts Info. > Groups > Create (Single Group)
- Enter Name as Debtors - North
- Against the field Under select Sundry Debtors from the List of Groups

The Group Creation Screen appears as shown below Figure:

Note: To create a Multi Group in Tally, go to Gateway of Tally >. Accounts Info > Groups > Under Multiple Groups > Select Create.



Short-Cut Key on Tally 9.o (Function Keys)

FunctionKey	Functionality	Availability
F1	To select a company	At all masters menu screen
	To select the Accounts Button	At the Accounting Voucher creation and alteration screen
F1 (Alt+F1)	To select the Inventory Button	At the Inventory/Payroll Voucher creation and alteration screen
F1 (Ctrl+F1)	To select Payroll Vouchers to alter	At the Accounting/Inventory voucher creation or alteration screen.
F2	To change the current date To select company inventory features	At almost all screens in TALLY At the F11: Features screen
F3	To select the company To select Company Statutory & Taxation features	At almost all screens in TALLY At F11: Features screen
F4	To select the Contra voucher	At Accounting / Inventory Voucher creation and alteration screen
F5	To select the Payment voucher	At Accounting / Inventory Voucher creation and alteration screen
F6	To select the Receipt voucher	At Accounting / Inventory Voucher creation and alteration screen
F7	To select the Journal voucher	At Accounting / Inventory Voucher creation and alteration screen
F8	To select the Sales voucher	At Accounting / Inventory Voucher creation and alteration screen
F8 (Ctrl+F8)	To select the Credit Note voucher	At Accounting / Inventory Voucher creation and alteration screen
F9	To select the Purchase voucher	At Accounting / Inventory Voucher creation and alteration screen
F9 (Ctrl+F8)	To select the Debit Note voucher	At Accounting / Inventory Voucher creation and alteration screen
F10	To select the Reversing Journal voucher	At Accounting / Inventory Voucher creation and alteration screen
F10 (Ctrl + F10)	To select the Memorandum voucher	At Accounting / Inventory Voucher creation and alteration screen
F11	To select the Functions and Features screen	At almost all screens in TALLY
F12	To select the Configure screen	At almost all screens in TALLY

1.8.3. Tally software functions with plenty of shortcut keys. The following are the list of shortcut keys available at every voucher entry screen report, masters' screens, configurations screens.

Shortcut keys on numbers in tally ERP 9:

F1:	select the accounts button and inventory buttons
F2:	change the menu period
F3:	select the company
F4:	select the contra voucher
F5:	select the payment voucher
F6:	to select receipt voucher
F7:	select journal voucher
F8:	select the sales voucher
F9:	select the purchase voucher
F10:	select the reversing journal voucher
F10:	select the memorandum voucher
F11:	select the functions and features screen
F12:	select the configure screen
Alt + 1:	insert a voucher
Alt + 2:	create duplicate voucher
Alt + F1:	View detailed report explode a line into its details
Alt + F2:	change the system period
Alt + F3:	create/alter/shut a company
Alt + F4:	select the purchase order voucher type
Alt + F5:	select the sales order voucher view monthly and quarterly report
Alt + F6:	select the rejection out voucher change the sales order voucher type
Alt + F7:	select the stock journal voucher accepts all audit lists
Alt + F8:	select the delivery note voucher view the columnar report
Alt + F9:	select the receipts note voucher
Alt +F10:	select the physical stock voucher
Alt + F12:	filter the information based on the monetary value

Ctrl + F6: rejection in

Ctrl + F8: select the credit note voucher

Ctrl + F9: select the debit note voucher

Ctrl + F10: memorandum voucher

Short Answer Questions (2 Marks)

1. What is Tally?
2. What is GST?
3. Write any two features of Tally?
4. Write a syntax of company creation in Tally?
5. What is Voucher?
6. What is pre – defined vouchers in Tally?
7. How many types of function keys in Tally? What are they?

Essay Type Questions (6 Marks)

1. What are the features of Tally?
2. How to create a company in tally? Write the procedure?
3. Write the inventory features in Tally?
4. Write the procedure for voucher creation in Tally?
5. Write the procedure for ledger creation in Tally?
6. Write about function keys and their Functions?

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4. PSSCIVE, Bhopal Materials.

BANKING AND RETAIL MANAGEMENT

2ND YEAR PAPER – II

BUSINESS ACCOUNTANCY -II (THEORY)

MODEL QUESTION PAPER

Time: 3Hrs **Max Marks: 50**

SECTION - A

Answer All the Questions Each Question Carries Two Marks 10×2=20

1. What is Non – Trading Concerns?
2. What is Revenue Expenditure?
3. What is Hire Purchase System?
4. What is Statutory Reserve?
5. What is Depreciation?
6. Write the Principles of Annual Depreciation, Rate of Depreciation?
7. What is Joint Venture?
8. What is Goodwill?
9. What is Company?
10. Who is Share Capital?

SECTION - B

Answer any Five of the following. Each Question Carries Six Marks. 5×6=30

11. What is the difference between Receipts and Payments a/c and Income and Expenditure a/c?
12. Calculate Interest in Each Installment from the following:
    i) Cash Price Rs. 9000.
    ii) Down Payment Rs. 3000.
    iii) Three Installments (each Installment Rs. 3000 each).
13. Write the Proforma of Balance Sheet as per Bank Regulation Act.

14. Mr. Ravi purchased a machine for Rs.68,000 on 1st January 2017. The residual value after 10 years is Rs. 8,000. Calculate depreciation chargeable under equal installment method at the end of 31st December of every year. Prepare machinery account for 3 years.

15. Write the differences between Joint Venture and Consignment?

16. A and B are carrying on business in a partnership, sharing profit & Losses in the ratio of 2:3. Their Balance sheet as at 31-3-2019 was as under.

Balance Sheet

Liabilities	₹	Assets	₹
Sundry Creditors	50,000	Cash in hand	30,000
Capital Accounts:		Cash at Bank	20,000
A	2,80,000	Sundry Debtors	1,00,000
B	4,20,000	Stock	2,00,000
		Furniture	50,000
		Buildings	3,50,000
	7,50,000		7,50,000

On thatdate they admit 'C' in to partnership and given him 1/4th share in the future profit on the following terms:

(a) 'C' is to bring in Rs.3,00,000 as his Capital and Rs.1,00,000 as good will, which sum is to remain in the business.
(b) Stock and Furniture are to be reduced in value by 10%
(c) Buildings are to be appreciated by Rs. 50,000
(d) 5% provision to be created on sundry Debtors for doubtful debts.
Prepare Revaluation Account.

17. Anitha Limited issued 30,000 equity shares of Rs. 100 each payable at Rs. 30 on application, Rs. 50 on allotment and Rs. 20 on 1st and final call. All money was duly received. Record these transactions in the journal of the company.

18. What are the Features of Tally?

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BANKING AND RETAIL MANAGEMENT (BRM)

SECOND YEAR PAPER – III

RETAIL MANAGEMENT

INDEX

UNIT – I

ESSENTIALS OF RETAILING

Meaning and Definition of Retailing - Retail Organization and Retail Procedure Drivers of Retailing - Socio economic Factors - Issues and challenges of Indian Retail - Super Bazar - Big Bazar – Malls - Departmental Stores

---

Learning Objectives:

After studying this unit, the student will be able to-

- Know the Retailing and Indian retail
- Comprehend the Drivers of retailing
- Understand the challenges of Indian retail

Introduction:

Meaning and Definition of Retailing:

Retailing refers to all the activities directly related to the sale of goods and services to the final consumer for personal use. In other words, a retailer or retail store is one, who stands at the final point of the supply chain and directly sells to the end users. The retailer buys in large quantities and sells in small quantities. Examples, Medical shops, Kirana merchants, Fancy stores, Fruits / Vegetable vendors etc., Therefore one can understand, that the word 'retail' is derived from the old French word 'retailer' which means 'to break bulk'. In simple words, it indicates a 'first-hand transaction with the customer.'

Functions of Retailer

From the above mentioned concept of retailing or retailer, one can understand the major functions of retailer as follows:

A Retailer buys a wide variety of goods from different wholesalers based on the customer demand.

A Retailer gathers the best products from the wholesalers and brings all the goods under one roof.

A Retailer maintains a ready stock of goods and displays them in his / her shop.

A Retailer always keeps himself / herself in regular touch with the customers, and this builds up good personal relations.

A Retailer helps the loyal customers with the facilities of credit selling, door delivery of goods, supply of desired quality or variety. etc.,

Therefore, it is not an exaggeration to state that there is no single person in any civilized Society, without having any relationship with the retailers. Human life is impossible without the services of retailers. Due to the growing importance of retailing, the form, size and nature of retailing have been radically changing world wide. Earlier, the retailers were small in size and ran their business mostly with family members. Now-a-days the retailing business is also owned and ran by Multi-National Companies (MNCs) like Walmart, McDonalds, Metro and Boots.

1.1.1. Importance of Retailing:

Benefits of Retailing to Consumers:

1. Employment Generation: Retailers involve in high annual sales and generation of employment. The important source of employment in retailing offers a large range of career opportunities such as store management, merchandising and owning a retail business.

2. Supply of Variety of Products: Retailers can perform marketing functions that make it possible for the customers to have access to large range and variety of products and its services. Retailing also helps to create the utilities of place, time and possession. A retailer's service also helps to increase a product's image.

3. Retailers participate in the sorting process by collecting a different type of goods and services from a large range of suppliers and offering them for sale.

4. Retailers provide information to consumers through media like television, radio, newspapers, hoardings and sales personnel.

5. Retailers store merchandise, mark prices on it, place products on the selling floor and otherwise they handle products safely. Generally, they pay suppliers for items before selling, then to final customers. Retailers complete their transactions by using appropriate locations, timings, credit policies and other services like delivery.

6. Usually, retailers act as the vital link between manufacturers / producers and ultimate consumers.

1.2. Retail Organization and Retail Procedure:

Organizational Structure of a Retail Business:

Organizational structure is important while creating a business plan. Such plan would help not only the retailers in distribution of work and responsibilities among the staff but also the customers in different ways.

Generally, in the modern retailing business, the organizational structure focusses on three aspects / operations.

1. Centralized Operations: They include duties like store layout, store planning and Human Resource Management.

2. Store Operations: They include merchandising and marketing and are performed regularly by stores.

3. Regional Operations: They refer to distribution and warehousing.

1.2.1. The process of organizing a retail firm basically includes the following five steps:

Figure 1: Process of Organizing a Retail Firm

Ascertainment of tasks to be performed in a retail distribution channel

↓

Division of tasks among channel members and customers

↓

Grouping the retailer's tasks into responsibilities

↓

Classification of jobs

↓

Developing an organizational chart

An organization structure that has adopted a policy of central buying in order to cut costs but it neglects the specific requirements of its various retail chain stores would be a fatal decision in the long run. This is normally in newly established retail outlets but finally retailers will have to understand that individual attention should be given to buying, pricing, wrapping and displaying products, considering geographical, social and cultural differences. There are several ways of organizing to perform these functions and focus on customers' needs, employees and management requirements.

1.2.2. The process of setting up a retail organization - Five steps:

1. Tasks to be performed: The common tasks in retail organization may change from one organization to another and also depend upon the size of the organization.

They are as follows:

i. Arranging and buying merchandise for the retailer

ii. Receiving merchandise and check it for the quality

iii. Determination of prices i.e., setting of the price to the product and labelling

iv. Inventory management and control including the stores

v. Customer complaint and grievance handling

vi. Payment operations (e.g., cash, credit / instalment)

vii. Free gifts like scratch cards

viii. Returning the damaged or unsold products to vendors

ix. Estimating the market demand

x. Service after sales i.e., any repairs in the product

2. Division of tasks between channel members and customers:

The above mentioned different activities take place in a retail channel. Some of these activities are generally performed by the manufacturer, wholesaler, customer or retailer himself.

1.2.3. The below diagram shows the details of activities that are performed by various parties in retail chain:

Figure 2: Division of Retail Activities

Party	List of Activities
Manufacturer or Wholesaler	Pricing, marchandise, inventory control, display layout preparation, research, sales forecasting, checking quality of incoming inventory, etc.,

Professional	Site arrangement, R&D, advertising, wareshousing, legal issues, credit maintenance, computer service, etc.,
Customer	Acceptance of delivery, bill payment, self service, selecting merchandise, product replacement.
Retailer	Buying the different types of products and coordination between various activities.

This is a list of possible activities that are generally performed in a retail chain. But an activity should be performed only if it is as per the need of the target market. e.g., free home deliver for the produts.

Costly products like ornaments and cosmotics the customers, like to take away with them. But in case of home needs / grocery, the customers would be requiring home delivery.

Once a facility is provided to the customers, it should be done with proper competence. For instance complaint handling activity may require a dedicated and knowledgeable employees to understand the customers grievances. In case of some retail stores, this activity can be handled by the retailer itself. But, when the store size is large and customers flows is high it requires separate staff for handling the customers grievances, needs etc.,

3. Grouping tasks into responsibilities:

After considering and finalizing various retail activities necessary to be performed in a store, a retailer groups these activities into job profiles those will be handled by a particular employee or a group of employees. For successful retailing, various activities should be defined and properly grouped. The following table shows how a retailer does task grouping and assigning tasks into jobs.

Figure 3: Grouping Tasks into Responsibilities

Activities	Jobs
Arranging and displaying the products in a particular order, customer's reaction, collection of customer's views, gift wrapping, guide / advice to customers	Floor Staff
Receiving stock / inventory, cheching for its quality, keeping record of issue and receipt, inventory / stock storage, returning inventory / stock to sellers.	Inventory Staff

Management of receipts, ledger maintenance, providing packaging materials like poly bags, bills issuance maintaining data related to credit / card purchasing	Cashier
Inventory repairs, alterations and setting, attending customers queries, compalints handling, R & D, follow up	Customer Care Staff
Recruitment of employees, training and developments, sales forecasting, estimating the demand, budgeting, pricing, coordination between various actitivies	Human Resource Staff
Cleaning store, washing floor, repairing shelves, racks and cabins	Janitorial Staff

After grouping the above activities, job descriptions should be prepared. The job description helpshuman resource department in recruitment of staff, selection, supervision and assigning pay scales to each job title.

4. Classification of Jobs: Classifing the jobs under functional, products, geographical or combination system.

Under functional classification, jobs are divided in terms of various retail functions, like sales promotion, customer care, inventory management and store operations.

Under products classification, jobs are divided on the basis of nature of goods and services. So, a retail store recruits different employees for apparels, electronics, electricals, vegetables, furnitures, grocery and food items etc., for this purpose employees' requirement in terms of experience, age, physical fitness, sex etc., it may varies from one product to another product.

Under the geographical classification, jobs are classified according to spread of the organization in various countries, states and cities. Therefore, job locations are assigned in such away that employee to the extent possible should work in or nearby home town .

Under combination classification system, stores use more than one classification. For example, if a retail store of luxury products like diamond, gold, platinum etc.,recruit their own staff for selling the products,but buys employees for each product line from head office and controlled by the head office, then it will be a combination of functional, geographical and product formats.

5. Developing an Organizational Chart: This is the final step of organizing a retail firm. For understanding the concept, various organizational patterns are shown below.

A. Organizational Patterns in Retailing - On the Basis of Functions

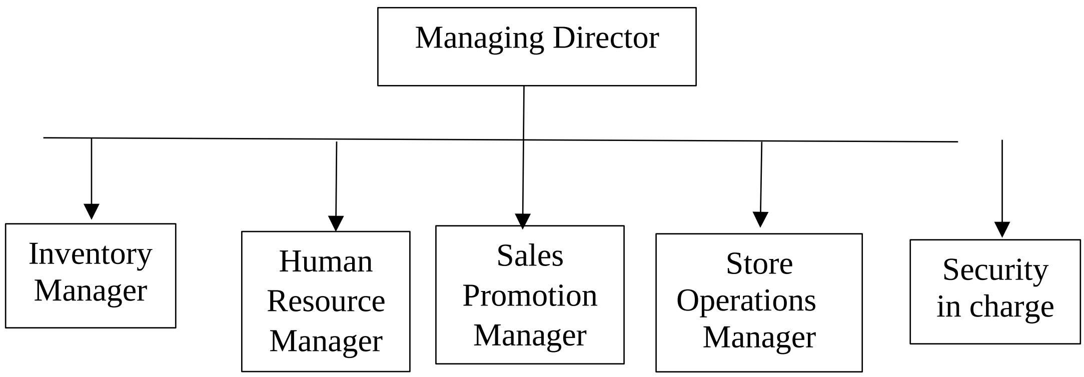

Figure 4: Organization Pattern on the Basis of Functions

B. Organizational patterns in Retailing – On the Ground of Merchandise Offered

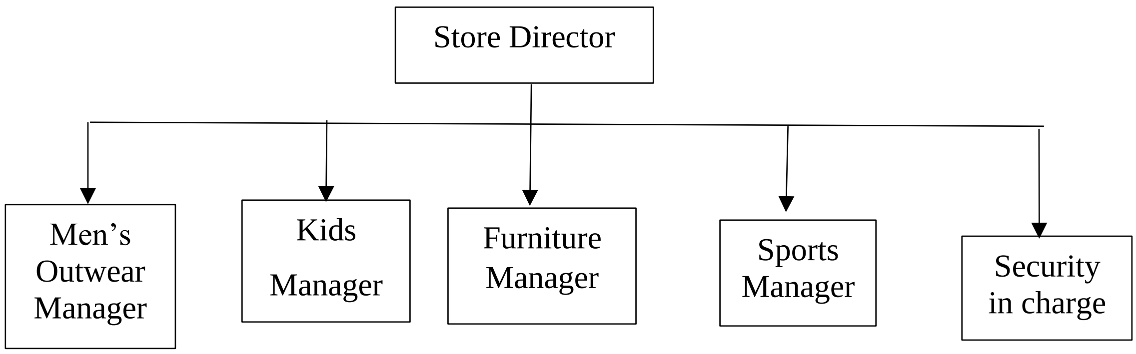

Figure 5: Organization Pattern on the basis of Merchandise Offered

C. Organizational patterns in Retailing – on the Ground of Geography

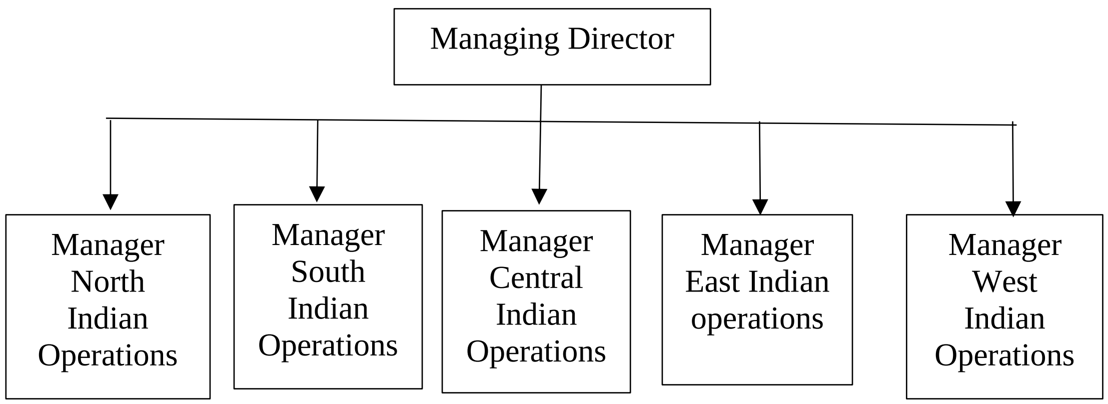

Figure 6: Organization Pattern on the Basis of Geography

1.3. Mixed Organizational Pattern:

These types of organizational patterns involve two or more organizational patterns available. So, they have the features of different organizational patterns. These are used when the store is expanded in terms of various branches, customers and variety of merchandise / goods.

1.4. Drivers of Retailing:

1.4.1. Meaning and Concept of 'Drivers':

Monitoring the performance and progress is the major task of top level management.

The drivers are leading that factors affect the performance of a company or business. A driver is something that has a big impact on whether the business does well or not. Without it, no decisions, guidance, plan or feedback are made.

Drivers are generally beyond the power of individuals to influence. People embedded in supply chain operations rarely connect change drivers to the tasks they perform daily. However, the need to adjust to these forces is always present, even if the need is unseen. Here we describe these drivers and explain how they compel changes in the retail supply chain. Those formulating projects to improve retail supply chains should understand and acknowledge their projects' "roots" in the form of drivers. This acknowledgment will lead them to identify and address important issues that increase chances for successful.

1.4.2. Key Drivers for Retail Growth:

The following are key drivers for retail growth:

1. Supply: Competitors are now moving to Tier II and Tier III cities to increase penetration and explore undeveloped markets as Tier I cities have been explored enough and have reached a saturation level.

2. Demand: Healthy economic growth, changing demographic profile, increasing disposable incomes, changing consumer tastes and preferences are some of the key factors that are driving and will continue to drive growth in the organized retail market in India.

3. Barriers to Entry: Reforms by India in opening up its economy have greatly improved trade prospects, but major barriers still exist such as regulatory issues, supply chain complexities, inefficient infrastructure, and automatic approval not being allowed for foreign investment in retail. However, some of these issues may be tackled with allowance of FDI in single and multi-brand retail.

4. Bargaining Power of Suppliers: The bargaining power of supplier varies depending upon the target segment, the format followed, and products on offer. The unorganized sector has a dominant position, still contributing above 90% to the total retail market. There are few competitors who enjoy an edge over others on account of being established competitors and enjoying brand distinction. Since it is a capital intensive industry, access to capital also play an important part for expansion in the space.

5. Bargaining Power of Customers: The bargaining power of customers shall be high due to wide availability of choice.

6. Competition: High competition is characterised by many factors, including variety of products, price, quality, service, location, reputation, credit and availability of retail space etc., Newcomers (business houses and international competitors) including foreign competitors are expected to further increase the competition.

1.5. Socio-Economic factors:

Socio-economic factors include income, education occupation, family, life-cycle, social, religion and culture. Some of them are explained hereunder.

1. Family Life Cycle: Family life cycle is a complex variable and is defined in terms of age, marital status, age of housewife and present age of children. Buying behavior changes with the stage of the family life cycle. Investigations have proved that the family life cycle exercises definite influence on consumer behavior with reference to purchase of durable as well as non-durable goods. Market for various products might be limited to one or a few of the various family cycles.

2. Social Class: Consumers may differ from one another, with regard to possession of scarce and valued things such as money, knowledge, or skills. The concept of social class is used to describe these differences. Social class is also a complex variable. It is based on income, occupation, education and place of residence. Social classes are relatively1 permanent homogeneous divisions in our society and each social class indicates similar life styles, values, interests and behaviors. Broadly speaking, we have at least three social classes. They are upper class, middle class, and lower class in every society.

3. Religion, Race and Culture: Religion, race and culture are also used as bases for segmentation. They can explain regularities and diversities in human behavior.

1.6. Issues and Challenges of Indian Retail:

There are certain issues to be addressed to if at all the projections of retail in India should hold true. Retailing, in India, is not at all free from limitations and restrictions. These

problems need to be addressed effectively. Starting right from the availability of infrastructure to managing the retail operations certain individual decisions& policy actions are to be undertaken. Each of these areas create some challenges that need to be taken care of at this stage.

Some of the Issues and challenges are mentioned below:

1. There is an urgent need to focus on the quality of services offered by the retailers to consumer. With the higher spendable income consumers are on lookout for something that is distinguishable from what others are providing. Most of them are enamored by consumers' tendency to spend but take less cognizance of the quality value that they could provide. This calls for differentiating their services exclusively and focusing more on the enlightening rather than satisfying the customer.
2. In the retail sector, one of the usual problems that remain uncontrolled is fraud and theft that take place in most of the supermarkets and hypermarkets. This is the biggest challenge to deal with in Indian retailing. Theft includes employee theft, shoplifting, vendor frauds which sometimes go unnoticed. If these incidents are not taken care of, the implications and size of this loss will be more serious and significant especially as retailers continue to scale up and increase their product line.
3. One of the major concerns is the problem of overcrowding, due to lack of space at majority of the retail outlets. This makes shopping more unmanageable, unenjoyable and time consuming. Quiet a many of Indian retail outlets have not thought about it even before planning the same.
4. The huge parking problems and lack of basic facilities have not yet been fully taken care of, especially, in the tier II cities where the chunk is maximum. Due to this the customer does not experience the ambience of shopping.
5. Dealing with employee related issues become still critical. The human resource management has been ignored to a great extent in the Indian retail industry. Better services can be provided only if employers are provided with a better quality of work life.

1.7. Super Bazar:

Meaning: Supermarket is also called as **Super bazars** in India.

Bazaar is a Hindi word, which means a market in English.

Supermarket is a large scale retail organization, selling a wide variety of consumer goods / products on the principles of self-service. They are rightly called as self-service stores. The customers have to serve themselves and there is no counter salesman to help the customers. Supermarkets are also called Food Fairs or Prick Quicks. It is a large scale of retail trading organization established in large-size premise dealing mostly in number of varieties of food products like groceries, vegetables, dairy products, eggs, meat, sweets etc., It is a retail trading organization which resembles departmental stores but has a distinctive feature of self-service.

Thus, supermarket is nothing but a retail organization providing food and house hold products to consumer under one roof without any kind of sales pressure from salesmen and sales assistance.

In India More, Reliance Fresh, Heritage Fresh etc., are some good examples of supermarkets.

1.7.1. Definition of Super Bazar:

According to Dictionary of Business Finance Supermarket / Super bazar is defined as

"Large store selling a wide variety of consumer goods, particularly food and small articles of household equipment."

Features of bazaars/ supermarkets:

1. Centrally located in large premises: Super bazars are normally established in a central locality places where large amount of space is available. It is housed in big premises. Without having the large premises proper display if various goods cannot be possible.

2. No sales pressure: Another important feature of a super bazar is self-service. There is complete absence of salesperson and sales assistance. Thus, there is no sales pressure on the customers. So, the customers can make selection according to their need and wants.

3. Maintains low prices: The prices of goods in the super bazars are reasonable or low. This is because they buy the goods in large quantities and get the advantages of bulk buying. At the same time salary bill to the employees is low because of the absence of salesperson and sales assistance.

4. Sell goods on a cash basis: Super bazars sell goods on Cash and Carry basis. In such kind of business, credit facilities are generally not offered. This reduces the bad debts.

5. Deals in necessaries of life: Super bazar sells the goods which the customers required regularly. Thus, they sell the products of well-known brands. Like groceries, provision, readymade garments, vegetables, meat and milk products etc.,

6. Established by companies: Super bazars are the retail stores which they are large in size. They run business on a large scale and require huge financial resources. Hence, they are normally established by Joint-stock companies.

7. Deals in pre-packed goods: Super bazar normally deals in pre-packed goods or products. It uses latest and up to date packing material to protect quality and quantity of the product. On all packages they print price, quality, quantity, grade, particulars of the products.

8. Needs large amount of capital to operate: Super bazar is a large trading organization. It requires a substantial amount of capital for large premises, huge warehousing, sufficient parking and stoking a wide variety of products.

1.8. Big Bazar:

Big Bazar was founded in 2001 by Kishore, the founder and chief executive officer (CEO) of the parent company, the Future Group. Big Bazar is an Indian retail store that operates as a chain of hypermarkets, discount department stores and grocery stores.

Big Bazar is a household name that is used synonymously with ‘retail’ in India. They represent the requirements of a typical Indian home. Big Bazar is one of the oldest hyper market chain having more than 250 branches in India.

Big Bazar is not just another hypermarket; it caters to need of every family. Where Big Bazar scores over other stores its value for money proposition to Indian customers. They guarantee the best products at the best prices. With the ever-increasing array of in-house brands, they have opened doors in the world of fashion and general merchandise, including home furnishings, utensils, crockery, cutlery, sports goods and much more at prices that will surprise the customers.

1.9. Malls:

Definition:

A shopping mall can be defined as a group of different stores offering various brands, products or service at on roof. A mall has many shops and companies can lease or buy these shops for setting up their own stores. In these days' malls are present almost every major city in the world and they selling the products / services like clothing, restaurants, groceries, movie theatres, electrical and electronic equipment etc.,

Malls are becoming a win to win situation for both companies and visitors, as people looking to shop have all the options under one roof and similarly, companies also have a huge range of audience they can target their products.

1.10. Departmental Stores:

Meaning of Departmental Store:

A departmental store is a large retail trading organization. It has various departments, which are classified and organized accordingly; departments are made as per different types of goods to be sold. For example, individual departments are established for selling packed food goods, groceries, garments, stationery, cosmetics, medicines, electrical and electronic equipment, furniture etc., so that customers can purchase all basic household requirements under one roof. It provides them maximum shopping convenience and therefore, also called a 'Universal Providers' or 'One Spot Shopping'.

All departments are run under the same ownership, management and control. Each and every department is an independent unit with regard to sale of any specific product and its varieties. The main aim of every department store is to provide all requirements of their customers at one place.

Short answer type questions:

1. Define retailing?
2. What is mixed organizational pattern?
3. What is super bazar?
4. Define Mall?
5. What are departmental Stores?

Long answer type questions:

1. Explain the importance of retailing?
2. Write the functions of retailer?
3. Explain the key drivers of retail growth?
4. What are the issues and challenges of Indian retail business?
5. List out the features of super bazars / super markets?

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UNIT - II

INVENTORY MANAGEMENT IN RETAILING

Types of Inventories - Planning of Inventory - Objectives of Inventory Management Stock Valuation and Recording in Retail - Role of Inventory Supervisor - Duties and Responsibilities of Inventory Supervisor - Inventory Planning Methods

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Learning Objectives:

After studying this unit, the student will be able to-

- Know the types of Inventory and their Management
- Acquaint the role of Inventory supervisor

Introduction:

Inventory is defined as a stock of goods. The storage of these goods is kept near the location of the retail store to meet the customers' demands. Inventory is very important for retailers because if goods are not available in the store the customers will immediately buy the product from another retailer. Usually, the retailer has to keep the inventory of finished goods in order to meet the customers demand.

Sometimes a firm may keep huge amount of inventory than is necessary to meet the demand of the customers and keep their factory running under current conditions of demand. If the firm exists an unstable business environment where demand is changing frequently (i.e., rises and falls quickly), on the other hand inventory could be maintained as a buffer against unexpected changes in demand. This buffer inventory could be maintained as a buffer against unexpected changes in demand. This buffer inventory also can serve to protect the firm if a supplier fails to deliver the product with in a time or if the supplier's quality is found to be incorrect while inspection, either of which would otherwise leave the firm without the necessary raw materials. Other reasons for maintaining an unnecessarily large inventory include buying to take advantage of quantity discounts (i.e., the firm save by buying in bulk), or ordering more to avoid any future price increase.

2.1. Types of Inventory:

A manufacturing organization holds inventory of raw materials and consumables required for production. It also holds inventory of semi-finished goods at various stages in the plant with various departments. Finished goods inventory is held at plant, distribution centres, FG Stores etc., Finished goods inventory is held by the organization at various stocking points or with dealer and stockiest until it reaches the market and end customers.

In addition to, raw materials and finished goods, organizations also hold inventories of spare parts to service the products. Damaged products, damaged parts and scrap also form part of an inventory. Inventory includes three forms:

1. Raw materials: The raw material inventory only includes items that have not yet been put into the production process. For example, raw coconut, in the case of coconut oil manufacturing.

2. Work in process: This process includes semi-finished stage.

This includes the cost of the labour directly doing the work and manufacturing overhead. Manufacturing overhead includes expenses indirectly related to manufacturing of the product.

3. Finished goods: After the process of production is completed the final product is called finished goods. The finished goods inventory also consists of the cost of raw materials, labour and manufacturing overhead, now for the entire product.

2.2. Planning of Inventory:

To proceed with merchandise planning, the method of inventory planning needs to be finalized.

Methods of planning inventory:

1. The Basic Stock Method
2. The Percentage Variation Method
3. The Week's Supply Method
4. The Stock / Sales Ratio Method
5. Stock Turnover Rate

1. The Basic Stock Method: This method is used when the retailer is necessary to have a particular level of inventory available at all times. Basic stock is the minimum amount of inventory that needs to be maintained for a product, category or store, even during the times of low sales.

Basic Stock = Average stock for the season – Average monthly sales for the season

Where, Average monthly sales for the season = $\dfrac{\text{Total planned for the season}}{\text{Number of months in the season}}$

2. The Percentage Variation Method: This Method is used normally when the stock turnover rate is more than 6 times in a year or when the stock is stable. The basic premise behind this method of inventory planning is that inventory levels should reflect the actual sales. It is calculated is shown below:

BOM stock = Average stock for season × ½ [1+ (Planned sales for the month / average monthly sales)]

3. Weekly Supply Method: Retailers who plan inventories on a weekly rather than monthly

basis and whose sales do not fluctuate substantially. This method is suitable for retailing organizations such as super markets / super bazars where sales do not fluctuate by significant amounts.

Number of weeks to be stocked = The number in weeks in the period / stock turnover rate period

Average weekly sales = Estimated total sales for the period / the number of weeks in the period.

4. Stock / Sales Ratio Method: This method is very easy to use, but it requires the retailers to have a beginning of the month stock / sales ratio. It involves the maintaining of the inventory levels at a specific ratio to sales. This ratio tells retailer how much inventory is needed at the beginning of the month, to support the month's estimated sales.

Stock sales ratio = Value of inventory / Actual sales planned.

5. Stock Turnover Rate: An effective measure of the speed with which product or merchandise moves in and out of a retail store for a given period, is the stock turnover rate. It is a measure of efficiency and is usually calculated for a period of six months or a year. It is calculated using the following formula.

$$\text{Planned sales (for a period)} = \frac{\text{Stock Turnover}}{\text{Planned Average Inventory (for a period)}}$$

2.3. Objectives of Inventory Management:

The following are the objectives of inventory management:

1. To ensure continuous supply of materials spares and finished goods so that production should not suffer at any time and the customer's demand should also be met.
2. To avoid both overstocking and under stocking of inventory.

3. To maintain investment in inventories at the optimum level as required by the operational and sales activities

4. To keep materials cost under control. So, they assist in minimizing the cost of production and overall cost.

5. To remove duplication in ordering stocks. This is possible with the help of centralizing purchases.

6. To design proper organization for inventory management. Clear cut accountability should be fixed at various levels of the organization.

7. To ensure permanent inventory control. So, that material shown in stock ledgers should be actually lying in the stores.

8. To ensure right quality goods at reasonable prices.

9. To facilitate furnishing of data for short term and long term planning and control of inventory.

2.4. Stock Valuation and Recording in Retail:

Inventory is normally valued at cost. The method of valuation of inventory depends on the type of the product. There are three methods for valuation of inventory.

1. First-in-First-Out (FIFO): This method is used for damaged goods and expiry date goods. Under this method the closing inventory is valued on the basis of the cost of goods purchased later. In case damaged goods like fruit, vegetables and food items. The goods purchased first and sold first. i.e., First-in-First-Out. Therefore, the unsold goods are valued at the latest price.

2. Last-in-First-Out(LIFO): This method is used for undamaged goods. Under this method the goods which are purchased later are sold first. The condition of goods which do not have any immediate expiry date are valued on this basis.

3. Weighted Average Method: Under this method weighted average approach, both inventory and the cost of goods sold are based upon the average cost of all units bought during the period.

4. Stock Recording: There ae two different methods of recording of inventory in the accounting.

1. Permanent inventory system updates inventory accounts after each purchase or sale. Inventory subsidiary ledger is updated after each transaction. Inventory quantities are updated continuously.

2. Periodic inventory system records inventory purchase or sale in "Purchases" account. Purchases account is updated continuously. However, "inventory" account is updated on a periodic basis, at the end of each accounting period (e.g., monthly, quarterly).

2.5. Role of Inventory Supervisor:

Inventory may be the second-highest expense next to payroll. So hiring the right person to supervise the inventory cost is necessary. The following are the responsibilities of the inventory supervisor.

1. Establishing Check-in Procedure: The inventory supervisor should establish procedures for receiving goods. Many times, seller invoices do not match with the number of goods actually received. The inventory supervisor must have a system in place not only for checking goods that come in, but also for reporting differences to management immediately.

2. Valuation Method: The inventory supervisor should establish either inventory valuation methods or stock inventory in such a way that it complies with the company's inventory valuation methods. If the inventory must be rotated for first-in-first-out valuation, the supervisor must place the older stock in the front of the shelves. If the company uses a last-in-first-out method, the supervisor should place new stock in the front of the shelves. Average cost inventory valuation does not require the supervisor to physically arrange the stock in any particular order.

3. Creating Stock Picking Procedures: Employees should be well trained and supervised so that they regain the stock in proper order. The supervisor must also make confirm employees enter the regained item in the inventory software system. This makes sure the software has the data to provide inventory level reports and reordering notices.

4. Dispatching Procedures: The inventory supervisor should dispatch the goods in a timely manner as part of order fulfilment. The dispatching procedures should include not only regain and packing of items, but record keeping informing the sales department items that have been dispatched to the customers.

5. Maintaining Minimum Inventory: Probably the most key role of the inventory supervisor is maintaining the minimum amount of inventory possible. This allows the firm to use less cash on excess inventory and apply it elsewhere, such as marketing and advertising.

2.6. Duties and Responsibilities of Inventory Supervisor:

1. Prepares purchase orders, receiving, storing and managing stock levels.

2. Maintains computerized inventory records that track plants from seed to sale, and any returns or recalls.
3. Takes action with respect to inventory discrepancies to identify errors and implement corrective actions.
4. Conducts monthly inventory audits.
5. Accounts for supply invoices and purchase orders.
6. Assists with identification of sources of supply
7. Communicates with all departments to ensure all inventory needs are met.

2.7. Methods of Inventory Control:

Inventories occupy the most important position in the working capital structure of manufacturing and distributive business enterprises. For example, on an average inventories are approximately 60 percent of the current assets in public limited companies in India.

The major production oriented methods and techniques of inventory control for managing inventories efficiently are the ABC analysis, the EOQ model, Safety stocks and the reorder point.

2.7.1. Methods and Techniques of Inventory Control:

1. ABC analysis: The Always Better Control (ABC) analysis is the classification and identification of different types of inventories, for determining the degree of control required for each. In this method, Inventory is classified under three broad categories A, B and C, on the basis of value, size, durability, utility, availability, criticality etc.,

The items included in group A involve largest investments and the inventory control should be most severe to these items. C group consists of inventory items which involve relatively small investments although the number of items remains large. The items deserve minimum attention of control. In B group that items are included which are neither of A nor C. This method can be explained by the following exhibit.

Classification of Inventory Items:

Class	No. of items (% of total)	Value of items (Rs.) (% of total)
A	20	85
B	30	10
C	50	5
Total	100	100

From the above figures, it can be observed that there are comparatively few items in A but they constitute a large proportion of the total rupee value; B items are in the intermediate range and C items are numerous but inexpensive.

2. Economic Order Quantity Model (EOQ): The basic decision in an economic order quantity (EOQ) procedure is to determine the amount of stock to be ordered, at a particular time so that the total of ordering and carrying costs may be reduced to minimum point. A form should place optimum orders and neither too large nor too small. The EOQ is the level of inventory order that minimized the total cost associated with inventory. The EOQ model is based on the following four assumptions.

(a) A firm has a steady and known demand (D) in units each period for a particular input.

(b) The firm consumes the input at a uniform rate.

(c) The costs of carrying stocks are a constant amount (C) per unit per period.

(d) The cost of ordering more inputs are a fixed amount (O) per order. Orders are delivered instantly.

The following formula for calculating the optimum order quantity is:

EOQ = $\sqrt{2DO/C}$

To show how we might use formula consider that a firm has an annual inventory requirement of 1000 units. The accounting costs associated with placing an order with the supplier come to Rs.20 per order and the carrying costs of holding stocks are expected to be Rs.2 per unit.

Hence D = 1000 units

O = Rs.20

C = Rs.2

EOQ = $\sqrt{2x1{,}000x20/2}$

= $\sqrt{10{,}000}$

=100 units

The EOQ model is very simple on and its assumptions will be unrealistic in many applications, in practice orders are not delivered instantly. The assumption of a constant usage of inventory and known annual demand are of doubtful validity.

3. Minimum Safety Stocks: To avoid stock-outs firms maintain safety stocks of inventory. The safety stock is the minimum level of inventory desired for an item given the expected usage rate and the expected time to receive an order. If an order is placed when the inventory reaches 5,000 units instead of 4,000 units, the additional 1,000 units constitute a safety stock.

The manager expects to have 1,000 units in stock when the new order arrives at the scheduled time. The safety stock protects as a safe-guard against stock-outs position due to unanticipated increase in usage resulting from an unusually high demand and / or an uncontrollable late delivery of inventories.

The increase in the amount of inventory held as safety stock reduces the chances of stock-out and therefore, reduces stock-out costs over the long-run. The level of inventory investment is, however increased by the amount safety stock. The optimum level of safety stock is determined by the trade-off between the stock-out and the carrying costs.

Thus the best level of safety stock for a given item depends on stock-out costs, variability of usage rates and delivery times. The safety stock level is the multiplication of the average demand during a period of the maximum, delay and the probability of its occurrence.

4. Re-order Point: In addition to set EOQ, the inventory management must know when to place the order for avoiding the stock-out position. Especially in the Indian context where there is a considerable time lag between placing the order and actual receipt of the inventory, determining the re-order point ROP) is momentous as well as intricate. The ROP may be defined as that level of inventory at which a fresh order should be placed to the suppliers for replenishing the current stock.

The ROP is calculated as the lead time X daily usage. The lead time is the time lag between raising an order and the goods being delivered. For example, if the normal daily usage of materials is 200 units and it takes 30 days for the supplier to deliver the goods, then an order must be sent out when the stock level reaches 6,000 units. If safety stocks are held then re-order level should be: safety stock + (lead time x daily usage.

Short type questions:

1. Define Inventory?
2. What is ABC Analysis?
3. What is EOQ?
4. What is Reorder Point?

Long answer type questions:

1. Explain the Types of Inventories?
2. What are the Objectives of Inventory Management?
3. Write about the Stock Valuation and Recording in Retail?
4. Discuss the Role of Inventory Supervisor?
5. What are the Duties and Responsibilities of an Inventory Supervisor?

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UNIT – III
SUPPLY CHAIN MANAGEMENT IN RETAILING

Basic concepts of SCM - Advantages and limitations of SCM -. Elements of SCM Principles of SCM - Direct and indirect distribution - Types intermediaries in SCM Channels of distribution for services - Steps in SCM.

Learning Objectives:

After studying this unit, the student will be able to-

- Understand the concept of supply chain Management
- Comprehend the types of intermediaries in SCM
- Know the process of SCM

Introduction:

Channels are the organized structure of buyers and sellers that bridge the gap of time and space between manufacturer and customers. There are hundreds of ways goods and services can be distributed to customers. No single distribution matches or satisfies the needs of every firm. So, different channels are used to different market segments.

Logistics and supply chain management is an art of managing the flow of materials and products from the source of production to the end user. This system includes the total flow of material right from the stage of acquisition of raw materials to the delivery of finished goods and services. The effective logistics management can improve both cost and customer service performance of the company.

Definition: "Supply Chain Management can be defined as the management of flow of products and services, which begins from the origin of products and ends at the product's consumption. It also comprises movement and storage of raw materials that are involved in work in progress, inventory and fully furnished goods."

3.1. Basic Components of Supply Chain Management:

There are a million things which are consumed in everyday lives, and supply chain management weaves through it all, creating a harmonious and efficient environment. Any break in this chain can actually result in disruption of the system with a domino like effect. Supply chain management is made up of a few components that are very important as well as critical to the system. The following are some components of supply chain management.

1. Planning: This is the most important stage. Before the beginning of the entire supply chain, it is essential to finalize the strategies and put them into pace. Checking the demand for the product or service, checking the viability, costing, profit and manpower etc., are vital. Without a proper plan or strategy in place, it will be almost impossible for the business to achieve effective and long term benefits. Therefore, enough time has to be devoted to this phase. Only, after the finalization of the plant and consideration of all advantages and disadvantages, can one proceed further. Panning helps to identify the demand and supply trends in the market and this, in turn, helps to create a successful supply chain management.

2. Information: The world today is dominated by continuous flow of information. In order to be successful, it is essential that a business stays level with all the least information about the various aspects of its products. The market trends of supply and demand for a particular product can be best understood if the information is properly and timely spread through the many level of the business. Information is crucial in a knowledge-based world economy, and ignorance about any aspect of business may actually spell downfall for the prospects of the business.

3. Source: Supplier plays a very crucial role in supply chain management systems. Products and services sold to the end user are created with the help of different sets of raw materials. It is therefore necessary that suitable quality raw materials are procured at cost effective rates. If a supplier is unable to supply on time, and within the specify budget, the business is bound to suffer losses and gain the negative reputation.

It is crucial that a company procures good quality resources so it can create good quality products and maintain its reputation in the market. This necessitates a strong role for suppliers in the supply chain management system.

4. Inventory: For a highly effective supply chain management system it is essential that an inventory is kept and thoroughly maintained. An inventory means the ready list of items, raw materials, and other essentials required for the product or service. This list has to be regularly updated to separate available stock and required stock. Inventory management is critical to the function supply chain management, because without proper inventory management the production, as well as sale of the product, it not possible. Businesses have now started to pay more attention to this component simply because of its impact on the supply chain.

5. Production: Production is one among the most important aspects of this system. It is only possible when all the other components of supply chain are in arrangement with each other. For the process of production to start it is essential that proper planning and supply of goods, as well as the inventory, is well maintained. The production of goods it followed by testing, packaging and the final preparation for delivery of the finished product.

6. Location: Any business, that wants to survive as well as develop, needs a location which is profitable for the business. For example, a carbonated drink factory is setup in an area where water supply is short. Water is basic necessity of such business. The lack of water could hamper the production as well as affect the goodwill of the company. A business cannot survive if it has to share an already short raw material with the community. Hence, a suitable location, which is well connected, and very close to the source of essential resources for production is vital to business' prosperity. The requirement an availability of manpower must also be considered while setting up a business unit.

7. Transportation: Transportation is vital terms of carrying raw materials to the manufacturing unit and delivering the final product to the market. At each stage, timely transportation of goods is compulsory to support a smooth business process. Any business which pays attention to this component, and takes good care of it, will benefit from the production and transportation of its goods on time. It is essential that a company works towards a safe and secure transportation process.

8. Return of Goods: Among the various components that create a strong supply chain is the facility for the return of faulty / damaged goods, along with a highly responsive consumer grievance redress unit. As a part of a strong business process, one may expect the return of goods under various circumstances. Even the best quality control processes may have unavoidable short failure. In the case of such failures, automatically followed by consumer complaints, a business must recall the product or products and issue an apology. This not only creates a good customer bonding, but also maintains goodwill in the long run.

The eight components discussed here are interdependent and ensure a smooth supply chain management system. It ensures the success and reputation of a business. A business must focus all these components in order to create a perfect supply chain.

3.2. Advantages and Limitations of Supply Chain Management:

As the competition in the retailing industry in the recent past has developed enormously, the customers are now demanding more services. Retailers are therefore offering a broad variety of products at lesser prices and providing elevated levels of services in their supply chain to achieve a competitive advantage. Some of the chief benefits of supply chain management are listed below:

1. A proficient supply chain management practice facilitates the retailers to reduce the inventory carrying costs. There is also a growth in the responsiveness to the orders of the customers.
2. An efficient supply chain management helps reduce the lead time, thereby making products readily accessible to the customers.
3. Effective supply chain management aids in enhancing all business processes, like data accuracy, operational complexity reduction, supplier section, purchasing, warehousing and distribution for the retailers, etc.,
4. With an efficient supply chain, retailers can provide a diversity of product mix at reasonable prices to the customers.
5. Effectively managing the supply chain solutions can help conserve operational and transportation cost in the retailing industry.
6. The use of various technologies in the supply chain helps a retailer can obtain benefits of maintaining good relation with manufacturers. With use of RFID (Ratio Frequency Identification) inventory can be tracked, and ERP (Enterprise Resource Planning) aids in increasing the performance of the supply chain.
7. The supply chain can be enhancing customer satisfaction, if the quality is maintained throughout.

Limitations of supply chain management are mentioned below:

1. Sometimes supply chain management can be very expensive to implement.
2. Competitors can easily copy the strategy of supply chain management.
3. For better supply chain management, proper skills and experience is required to achieve success.
4. Sometimes in supply chain management various functions may be difficult to manage.
5. In supply chain management there may be staff resistance.

3.3. Elements of Supply Chain Management:

The supply chain process associated with various elements that are as follows:

1. Purchasing: The purchasing department receives a list of raw materials needed for the manufacturing the products required by the production department to complete the customers' orders for the products.

2. Inventory: After receiving the production planning details the required raw materials are listed and procured accordingly. The purchased raw material is then stored and used sequentially for the production of product. The suppliers send invoice to the company for the items delivered to the industry.

3. Production: According to the production plan raw materials moved from inventory to the shop floor for the further processing. The products are then manufactured according to the order made by the customer and on the materials send by the supplier. After the completion of all manufacturing processes on the material, finished goods or products are send to the quality checking department and then to the dispatch.

4. Transportation: The completed order in form of the finished goods or the products is ready to dispatch to the retailers for the selling of product to customers as per the orders made by the customers. The company will send the invoices for the delivered products.

3.4. Principles of Supply Chain Management:

Successful supply chain management is a complex method of distribution of product to the ultimate consumer. Within a broad supply chain management there can be a number of small supply chains which need to be managed. It includes suppliers, manufacturers, distributors and customers behave as if they are part of the same company. This way only they can enhance performance significantly across the chain.

There are seven principles of supply chain management:

Principle 1: Segment customers based on the service needs of distinct groups and adapt the supply chain to serve these segments profitably.

Principle 2: Customize the logistics network to the service requirements and profitability of customer segments.

Principle 3: Listen to market signals and align demand planning accordingly across the supply chain, ensuring consistent forecasts and optimal resource allocation.

Principle 4: Differentiate product closer to the customer and speed conversation across the supply chain.

Principle 5: Manage sources of supply strategically to reduce the total cost of owning materials and services.

Principle 6: Develop a supply chain-wide technology strategy that supports multiple levels of decision making and gives clear view of the flow of products, services, and information.

Principle 7: Adopt channel-spanning performance measures to gauge collective success in reaching the end-user effectively and efficiently.

These timeless principles highlight the need for supply chain leaders to focus on the customer. They also stress the importance of coordinating activities (demand planning, sourcing, assembly, delivery, and information sharing) within and across organizations.

3.5. Direct and Indirect Distribution:

A distribution channel is chain businesses or intermediaries through which a goods or services pass until they reach the end consumer. It can include wholesalers, retailers, distributor, and even the internet. Channels are broken direct and indirect forms. A direct channel allows the consumer to buy the good from the manufacturer, and an indirect channel allows the consumer to buy the good from a wholesaler or retailer.

Direct Distribution:

Direct channels tend to be more expensive to start running and can sometimes require significant capital investment. Warehouses, logistics systems, trucks and driving staff will ne to be setup. However, once those are in place, the direct channel is likely to be shorter and less costly than an indirect channel. Direct selling can be difficult to manage on al large scale, but it often allows the manufacturer to have a better connection to its consumer base.

Indirect Distribution:

The most challenging part of indirect distribution channels is that another party has to be entrusted with the manufacturer’s products and customer interaction. However, the most successful logistics companies are experts at delivering receivable in a way that most manufacturers cannot be. Indirect channels also free the manufacturer from any start-up costs. With the relationship, they are much simpler to manage than direct distribution channels.

3.6. Types of Intermediaries in Supply Chain Management:

Unless customers are buying a product directly from the company that makes it, sales are always facilitated by one or more marketing intermediaries, also known as middlemen. Marketing intermediaries do much more than simply take a portion of the turnover with each transaction. Not only do they give customers easier access to products, they can also streamline a manufacturer's processes. Four types of intermediaries include agents and brokers, wholesalers, distributors and retailers.

1. Agents and Brokers: Agents or brokers are individuals or companies that act as an extension of manufacturing company. Their important job is to represent the producer to the final user in selling a product. Thus, while they do not own the product directly, they take possession of the product in the distribution process. They make their profits through fees or commissions.

2. Wholesalers: Wholesalers by products from manufacturers in bulk and then resell them, usually to retailers or other businesses. Some carry an extensive range of different products, while others specialize in a few products but carry a large assortment. They may operate cash-and-carry outlets, warehouses, mail order businesses or online sales, or they may simply keep their inventories in trucks, and travel to their customers.

3. Distributors: Distributors function similarly to wholesalers in that they take ownership of the product, store it, and sell it at a profit to retailers or other intermediaries. However, the main difference is that distributors combine themselves to complementary products. For example, distributors of Coca Cola will not distribute Pepsi products, and vice versa. In this way, they can maintain a closer relationship with their supplier than wholesalers do.

4. Retailers: Whenever a consumer buys a product from anyone other than the company that makes it, the consumer is dealing with a retailer. This includes corner stores, shopping malls an e-commerce website. Retailers may by directly from the producers or from another intermediary. In some markets, they may stock items and pay for them only after they make a sale, which is common for most bookstores today.

3.7. Channels of Distribution for Services:

Channel of distribution refers to those people, institutions or merchants who help in the distribution of goods and services. Philips Kotler defines channels of distribution "a set of independent organizations involved in the process of making a product or service available for use of consumption". Channels of distribution provide convenience to customer, who can get various items at one store. If there were no channels of distribution, customer would have faced a lot of difficulties.

There are four major types of distribution channels, they are mentioned below:

1. Direct Channel
2. Indirect Channel
3. Selective Distributive Channel
4. Intensive Distributive Channel

1. Direct Channel: When the manufacturer or the producer supplying goods directly to the consumer is called direct channel. The manufacturer in this state of distribution channels performs all the marketing functions himself. No middlemen are involved. In the direct

Channels of distribution, the manufacturer attempts to reach the consumers through their own retail stores, house to house selling, by mail and by sales from the factory door.

2. Indirect Channel: Indirect channels are also called exclusive distribution channels. It can be defined as marketing of goods first to retailer who in turn sell it to consumers is known as indirect channel of distribution. It is a most effective method of products distributions, and effectively used for promoting clothes, machines, automobiles, furniture's etc.,

3. Selective Distributive Channel: The marketing through wholesaler in one of the widely used ways of distribution in all over the world. These distribution channels enable the manufacturer to sell goods in lot to a few selected wholesalers, who sell it to retailers, who further in turn to sell products to the consumers. The wholesaler acting as middlemen, take little to the goods, assume risks, appoint dependable retailer, provide goods on cash as well as a credit and thus spreads sale on a wide market.

4. Intensive Distributive Channel: In intensive distribution channels, the producer uses many wholesalers and retail middlemen for the promotion of the product. The producer uses this route of marketing for saturating the market with the product.

3.8. Steps in Supply Chain Management:

Supply Chain Management process plays a huge significance in running key operations for almost every organization. Without a successful supply chain, processes could halt at the floor level and ultimately bring down the results.

Supply Chain Management process involves following five steps:

1. Plan: Planning involves a wide range of activities. Companies must first decide on their operations strategy. Whether to manufacture a product or component or buy it from supplier is a major decision. Companies must analyze the advantages and disadvantages of different options presented by international supply chains. Planning involves mapping out the network of manufacturing facilities warehouses, determining the levels of production and specifying transportation flows between sites.

2. Source: This step in supply chain management involves organizing the procurement or raw materials and components. Procurement is the acquisition of goods and services at the best possible price, in the right quantity, right quality and at the right time. When sources have been selected and evaluate, companies must negotiate contracts and schedule deliveries. Supplier performance must be assessed and payment to the suppliers made when appropriate.

3. Execute: This is the stage for implementing the plans and the manufactured products are ready for testing, packing, and delivery. Results at this stage are quantified so that maximum possible efficiency is achieved.

4. Deliver: When supply chain reaches this stage, the managers have a task at hand to deliver the product or service in the right quantity, right quality and right time by employing suitable carriers. Supply chain managers should be fully equipped with modern IT tools to keep a track on warehousing networks, inventory modes as well as invoicing and payment receipts.

5. Return: This is the last step of supply chain management. Return is associated with managing all returns of defective or damaged products, including identifying the product condition, authorizing returns, scheduling product shipments, replacing defective or damaged products and providing refunds. Returns also include “end-of-life” products (those that are in the end of their product lifetime and vendor will no longer be marketing, selling, or promoting a particular product).

Short answer type questions:

1. Define SCM?
2. What is direct distribution?
3. What is indirect distribution?
4. What are the limitations of SCM?

Long answer type questions:

1. Write the basic components of supply chain management?
2. Write the advantages of supply chain management?
3. Explain the elements of supply chain management?
4. Write the principles of supply chain management?
5. Explain the types of intermediaries in supply chain management?

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UNIT - IV

NON - STORE RETAILING

E-Retailing - E-Marketing - Telemarketing -. E-Marketing Vs. Traditional Marketing - Internet Business

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Learning Objectives:

After studying this unit, the student will be able to-

- Aware of the concept of E-Retailing
- Understand the Telemarketing
- Know the distinction between Traditional Marketing and E - Marketing

Introduction:

In this era of rapid globalization, the online form of retailing has emerged as a strong tool to sell products, directly to the customers, and is growing much quickly. As anyone with a computer or Smartphone can attempt on line retailing, is now extensive, penetrating every demographic group and retail segment to varying degrees.

As a matter of fact, just like developed nations, the retail sector in India too, is going through the phase of huge transformation. The impact of the alternation in the format of the retail sector changed the lifestyle of the Indian consumer totally. Nowadays the Indian consumers are well versed with the concepts about quality of products and services. These demands are the visible impacts of the Retail Sector of Indian Economy.

4.1. E-Retailing:

Definition: Electronic Retailing is the sale of goods and services through the internet. E-Retailing, or E-Tailing, can include business-to-business (B2B) and business-to-consumer (B2C) sales of products and services, through subscription to website content, or through advertising.

The E-Retailers can be of two types:

1. Pure Play E-Retailers: Such as amazon, that emerged as the online bookseller. It is present only online and do not have any physical outlet for the customers.

2. Brick and Click E-Retailers: Such as Dell, that sells computer through the internet as well as the physical store front for the customers.

4.1.1. Importance of E-Retailing:

E-Retailing is becoming an essential part of all the courses in management and commerce. It is an integral part of any book or manuscript that is written on retailing, and it claims significant share in this text also. The reason behind this lies in the fact that E-Retailing technology is different and more powerful than any of the other technologies we have seen in the past century.

While these other technologies transformed economic life in the 20th century, the evolving Internet and other ITs will shape the 21st century in many ways. The foremost of these is the rise of a sizeable class of Internet-habituated consumers, and then is the creation of an ecosystem essential for E-Retailing's growth. In India's case, both these factors are poised to fall into place rapidly

Prior to the development of E-Retailing, the process of marketing and selling goods was a mass-marketing and / or sales force-driven process. Consumers were considered as passive targets of advertising (promotional) "campaigns" and branding blitzes were intended to influence their long-term product perceptions (brand positioning) and immediate purchasing behavior.

4.1.2. Advantages and Disadvantages of E-Retailing:

Advantages:

1. Easy Access to Market: In many ways the access to market for entrepreneurs has never been easier. Online market places such as eBay and Amazon allow anyone to set up a simple online shop and sell products within minutes.

2. Information Sharing, Convenience, and Control: Electronic marketplaces improve information sharing between merchants and customers and promote quick, just-in-time deliveries. Convenience for the consumer is a major driver for change in various industries. Customers and merchants save money; are online 24 hours a day, 7 days a week; experience no traffic jams, no crowds, and do not have to carry heavy shopping bags.

3. Better Customer Service: Online customer service makes customer happier. Instead of calling a company on the phone, the web merchant gives customer direct to their personal account online. This saves time and money. For companies that do business with other companies, adding customer service online is a competitive advantage. The overnight package delivery service, where tracking numbers allow customers to check the location of package online, is one good example.

4. Widen the Market / Export: One major advantage over premises-based retailers is the ability to expand the market beyond local customers very quickly. Seller may discover a strong demand for his / her products in other countries which it can respond to by targeted marketing, offering the website in a different language, or perhaps partnering with on overseas company.

5. Customer Intelligence: Ability to use online marketing tools to target new customers and website analysis tools to gain insight into the customer’s needs. They are useful in order to advice for improving the customer’s on-site experience.

6. Lower Space: The best part of E-Retailing is it may be started with the single room with one computer and can expand very rapidly, rather than to pay for entire building with expensive.

Disadvantages of E-Retailing:

1. Security: Security continues to be a problem for online businesses. Customers have to feel confident about the integrity of the payment process before they commit to the purchase.

2. System and Data Integrity: Data protection and the integrity of system that handles the data are serious concerns. Computer viruses are uncontrolled, with new viruses discovered every day. Viruses causes unnecessary delays, file backups, storage problem etc.,

3. Customer Relations Problems: Not many businesses realize that even E-Business cannot survive over the long term without loyal customers.

4. Cost-Effective: On the surface, the electronic marketplace seems to be a perfect market, where worldwide sellers and buyers share and trade without intermediaries. However, a closer look indicated that new types of intermediaries are essential to E-Commerce. They include electronic malls that guarantee legitimacy of transactions. All these intermediaries add to transaction costs.

5. Customer Trust: It is difficult to establish a trusted brand name, especially without a physical business with a track record and face-to-face interaction between customers and sales staff. Seller needs to consider the costs or setting up a good customer service system as part of his / her online offering.

4.2. E-Marketing:

Definition: E-Marketing (Electronic Marketing) are also known as Internet Marketing, Web Marketing, Digital Marketing, or Online Marketing. E-Marketing is the process of marketing a product or service using the Internet. E-Marketing not only includes marketing on the Internet, but also includes marketing done via E-Mail and wireless media. It uses a range of technologies to help connect businesses to their customers.

4.2.1. 7 C's in E-Marketing:

The following seven C's should guide seller to create an effective marketing strategy that will give excellent results.

1. Context: A website's layout and overall visual design needs to be orderly, clearly, easy to read and navigate, the color scheme needs to be appropriate for the marketing design. Having some white space will also aid in the overall design and readability.

2. Commerce: If the website is intended for commercial transactions, then it has to be safe and the fact that is has been made safe must be communicated to the customer, most websites use a "lock" symbol in the corner to indicate that it has been encrypted.

3. Connection: Any links that lead the customer away from the website.

4. Communication: How the company talks to its customers. This can be done through signing up for special offers, email newsletters, contests, surveys, live chat with company representatives, and company contact information.

5. Content: The text, graphics, sound, music, and / or videos that are presented.

6. Community: The website may allow interaction between customers through message boards and live chat.

7. Customization: Companies can allow customers to personalize aspects of the website or it may tailor itself to different users, for example having different colors and graphics for people who speak different languages.

4.3. Telemarketing:

Telemarketing is a very common form of marketing companies use to connect with potential customers of their products or services. Historically, telemarketing consisted of companies making telephone calls to existing or potential customers. With new technology, telemarketing has expanded to include video conferencing calls as well, although those are typically conducted with existing customers. Telemarketing is often used to try to sell a product or service, but it can also take the form of surveys or information gathering. For instance, political campaigns us telemarketing heavily prior to elections to inquire about voting preferences.

When companies call new customers, the activity is referred to as "cold calling". This means the consumer has not purchased from the company before nor have they requested a call from the company. Companies can buy a list of potential customers to call from the list which will provide a list of consumers who have similar interests on purchasing that fit the company's target market.

There are many industries that depend heavily on telemarketing, such as:

- Cable and Internet services.
- Home security systems.
- Financial services.
- Vacation and time share.
- Charitable organizations.

4.3.1. Importance of Telemarketing:

Here are the top four reasons why telemarketing is important for any business:

1. Direct Contact with Clients: Telemarketing enables a business to talk to actual people. Unlike other communication channels, telemarketing ensures that salesman communicating with the right person because they are live and on the other side of the phone. Further, salesman can estimate and analyze their reactions.

2. Instant Feedback: Unlike E-Mail marketing, telemarketing gives immediate feedback. This helps a business better adjust its message and ensure that it delivers for its customers.

3. Reduced Operational Costs: Telemarketing is a cheap form of communication per contact. All it requires is a list to initiate contact. This is far less than door-to-door marketing, advertising via print and electronic media or developing promotion tools such as brochures or posters.

4. Cost-Effective: Not only does telemarketing fare well against other communication methods, it also is cost-effective. Leads are the lifeblood of every business, and telemarketing puts a business directly in touch with those leads whereas other methods are less direct and less able to drum up new business or ensure that old business stays with a company. The money spent on telemarketing pays off handsomely in almost every case.

4.3.2. Advantages and Disadvantages of Telemarketing:

Advantages of using Telemarketing:

1. Human Interaction: One of the advantages of telemarketing as compared to other direct marketing methods is that it involves human interaction.

2. Small Businesses: Telemarketing is a particularly valuable tool for small businesses, in that it saves time and money as compared to personal selling, but offers many of the same benefits in terms of direct contact with customers.

3. Customer Service: Building a loyal client base is a fundamental factor in establishing a long-term business success and increasing the value of the company. Telemarketing customer services can gain repeat orders and increase the penetration of the customer base. Telemarketing has the advantage of delivering excellent customer service.

4. Reduces Cost: As the costs of field sales continue to increase, businesses are using telemarketing as a way to reduce the cost of selling. It is also easier to communicate with customers. Most of the marketing efforts are directed towards select markets, so the cost per person contacted is less.

5. Flexibility: It is the most flexible form of direct marketing. It helps in knowing and understanding what customers want, and are prepared to buy. Survey can be conducted with the advantages of telemarketing, knowing what customers are looking for, the product or service, the brand, etc., one can constantly update the client data base.

6. Response Measurement: Response measurement is possible by knowing the effectiveness of advertising. The results can be compared with the ones previously established, and the future plans can be based on such results.

Disadvantages of Using Telemarketing:

1. An increasing number of people have become opposed to telemarketing.
2. No visual contact with the customer is possible.
3. More people are using technology to screen out unwanted callers, particularly Telemarketers.
4. If hiring an outside firm to do telemarketing, there is lesser control in the process, given that the people doing the calls are not your employees.
5. A telephone conversation has very short memory.
6. Pre-purchase inspection of goods not possible.
7. It can be extremely expensive, particularly if telemarketing is outsourced from an outside firm.

4.4. E-Marketing Vs Traditional Marketing:

Technology affects traditional ways of marketing in three ways. IT increases efficiency in marketing, it transforms marketing strategies and it changes the consumer behavior due to the power shift from firms to those who use technology.

1. E-Marketing is cheaper while traditional marketing is expensive and requires large investment.

2. The Internet deal procedure is well thought of delivering goods traditional deal procedure, which done as real time deal, and therefore a lack of product.
3. E-Marketing is the product of the meeting between modern communication technologies whereas traditional marketing remains to be standing or motionless.
4. The return on investment (ROI) from E-Marketing can far exceed that of traditional marketing strategies.
5. Traditional marketing depend on highly trained and experienced personnel to be implements while E-Marketing just need few people to initiate the process and the rest will be done in an automated system.
6. By having a social media presence and managing it carefully, seller can build customer loyalty and create a reputation for being easy to engage with.
7. E-Marketing creates engaging campaigns using different types of rich media. On the internet these campaigns can gain social currency being passed from user to user and becoming viral.
8. Many aspects of the E-Marketing activities can be automated within the online or offline system making time serving. This enables the seller to do other strategic business activities.

4.5. Internet Business/ E-Business:

Internet business, also known as E-Business or electronic commerce, refers to conducting business transactions over the Internet, which includes exchange of information of value in the form of products and services as well as payments, using web-based technologies.

4.5.1. Internet Business Subsets:

E-Commerce or electronic commerce, a subset of E-Business, is the purchasing, selling, and exchanging of goods and services over computer networks (such as the Internet) through which transactions or terms of sale are performed electronically. Contrary to opposing to popular belief, E-Commerce is not just on the web. In fact, E-Commerce was alive and well in business to business transactions before the web back in the 70s via EDI (Electronic Data Interchange) through VANs (Value-Added Networks). E-Commerce can be broken into four main categories. i.e., B2B, B2C, C2B, and C2C.

1.B2B (Business-to-Business): Companies doing business with each other such as manufacturers selling to distributors and wholesalers selling to retailers. Pricing is based on quantity of order and is often negotiable.

2. B2C (Business-to-Consumer): A website following B2C business model sells its products directly to a customer. A customer can view the products shown on the website. The customer can choose a product and order the same. The website will then send a notification to the business organization via email and the organization will dispatch the product or goods to the consumer.

3. C2B (Consumer-to-Business): In this model, a consumer approaches a website showing multiple business organizations for a particular service. The consumer places an estimate of amount he / she want to spend for a particular service. For example, the comparison of interest rates of personal loan / bike loan provided by various banks via websites. A business organization who fulfils the consumer's requirements within specified budget, approaches the
customer and provides its services.

4. C2C (Consumer-to-Consumer): There are many sites offerings free classifieds, auctions, and forums where individuals can buy and sell thanks to online payment systems like PayPal where people can send and receive money online with ease. eBay's auction service is great example of where person-to-person transactions take place every day.

Short answer type questions:

1. Define E-Retailing?
2. Define E-Marketing?
3. What is Telemarketing?
4. Purpose of Internet Business

Long answer type questions:

1. What are the advantages of E-Retailing?
2. Explain the 7C's in E-Marketing?
3. Elucidate the importance of Telemarketing
4. Distinguish between E-Marketing Vs Traditional marketing?
5. Explain the Internet Business?

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UNIT - V

EVENT MANAGEMENT

Importance of Event Management - Types of Events - Steps in Event Management- Documentation for Conducting Events - Principles of Event Management - Check List for Event Manager - Tips for Organizing an Event

Learning Objectives:

After studying this unit, the student will be able to-

- Understand the significance of Event Management
- Acquaint the knowledge on types of events
- Know the role of event Manager

Introduction:

"Event Management" is the process of analyzing, planning, marketing, producing, and evaluating an event. It is a different way of promoting a product, service or idea. If an event is managed efficiently and effectively, it can be used as a very powerful promotional tool to launch or market a product or service. Event management requires certain core values to be established to every element, process and decision to justify professional approach and achieve effective and efficient results".

The events industry now includes events of all sizes from the Olympics down to business breakfast meetings. Many industries, charitable organizations, and interest groups hold evens in order to market themselves, build business relationships, raise money, or celebrate achievement.

5.1. Importance of Event Management:

The entire concept of event management is regarded as one of the most intense or significant form of advertising or marketing. The whole process of event management necessarily involves the organization process. This involves the organization of a personal or a professional event. This may generally involve the seminars, fashion show, wedding, product launches, exhibitions etc., In short, the event management involves the whole steps of conducting an event right from the planning, financing, conceptualizing etc., The present scenario, event management is an important area which has been evolving over the years along with the increasing opportunities.

Financial management is another aspect that the event management companies will handle for the success of the event. This helps to reduce the chance of the finance exceeding the budget limits. Organizing a big event is not an easy task. The organizing person if he / she is not having enough experience it will turn out to be a failure. So many planning has to be done like room hiring, catering special diets, financial planning etc., All these thing are taken care of by Event Management Companies.

5.2. Types of Events:

There are countless types of events, some are demanded frequently by customers, other are rarely find in depth information.

1. Fun Events: Fun events increase enthusiasm and participation. If a person enjoying the event in his own interest, then it could fall under the fun event category. For example, party, entertainment show, comedy show etc.,

2 Personal Events: Personal events can be broadly classified basing on the someone personal affair. The events such as, birthday parties, marriages etc., fall under this category.

3. Promotional Events: Any product or any brand, celebrity, inauguration programs, launch events, campaigning etc., can be seen under the promotional events category.

4. Corporate Events: Corporate events are defined under two categories-the in house affair and events for the public. For example, seminary, press conference, academic, business conferences.

5. Educational Events: Educational events can be categorizing as a training programs, learning session, workshops etc.,

6. Trade Shows Exhibitions: Trade shows exhibitions are the event in which companies can showcase their latest products. It is helpful in connecting the target audience. It is also a platform to launch a product.

7. Award Ceremonies: One of the best event to recognize the person by facilitating the awards. All sectors organize the award function event to gain the popularity.

8. Sports Event: Sports events are physical event, through organized participation. Sports event is major source of entertainment for the non-participant. For example, IPL super league, Football Match, Olympics etc.,

5.3. Steps in Event Management:

1. Develop Event Goals and Objectives: The very first step is to establish a tangible goal and objectives. (e.g., why are you organizing this event and what do you hope to achieve?)

If you know your organization's key goals before planning, you can ensure that every part of your event is optimized for success. Are you trying to raise awareness for a cause, or collected a predetermined amount of donations for your next project?

2. Organize a Team: Any event takes a concerned team effort to handle all of the details. Consider identifying one key Event Chair as well as individual Chairpersons for subcommittees, such as:

- Venue management
- Speakers
- Entertainment
- Publicity
- Sponsors
- Volunteer management

Assigning individual roles to team members creates system of accountability, as well as preventing tasks from falling to the wayside.

3. Set a Date: The date might already be pre-set for a recurring event, but if this is a new event, be sure to consider the following before firming up your date:

- Give yourself enough time! Ideally, you should have 4-6 months to plan
- Beware of statutory and religious holidays
- Avoid school holiday time periods (e.g., winter, spring and summer holidays)
- Check dates with key participants (e.g., speakers, presenters, VIP guests, etc.,)

4. Brand Your Event: If you want your event to stand out, you need to choose a timely and compelling theme that sets you apart from your competition. This means that you need to come up with a dynamic overall theme and you need to take great care with the actual name - since it can be a key attention-getter, especially in online media.

- Brainstorm names
- Create a Tagline
- Design a Logo

5. Create a Master Plan: This plan should surround all aspects of the event, including:

- Venue, Logistics, and Catering Management (contracts, permits, insurance, etc.,)
- Speakers / Presenters
- Activities / Entertainment
- Publicity / Promotion (online & off-line, e.g., web page & online promotion)
- Registration (online sign-up, payment and tracking; on-site sign-in, etc.,)
- Sponsor / Partner Management
- Volunteer Management

6. Determine Administrative Process: How are you going to keep track of your planning, registration, budget, guest and speakers lists, etc.,

If you are a Wild Apricot Membership Management client, you can quickly and easily create an event and manage your registration through our online event management system.

If your website or membership database is not powered by Wild Apricot, you may want to determine how to best organize and track all of your event information. You could review event management software tools through a directory.

7. Identify and Establish Partnership & Sponsors: Are there organizations that you could partner with or call on for sponsorships to meet the costs and increase potential participation? When you involve other people or groups in your event, they have a support in helping spread the word and making the event a success. You might want to consider.

i. Seeking Corporate Sponsors to fund a portion of the event.

ii. Partnership with community organization.

8. Crate a Publicity Plan: Even with the most amazing speaker or entertainment line-up, you need publicity to get people in the door. Event promotion starts with the initial notice or page on your website, not in your newsletter or email to save the date, and then builds to include online and off-line publicity, media relations and on-going exceed to encourage registration. And no plan is complete without the post-event than-you' s, sponsor acknowledgements and articles about the event's key messages or fundraising success.

9. Establish a Budget: Your budget should incorporate estimates for all of the key items identified on your event master plan. Don't forget to include any travel or accommodation costs for speakers, presenters, etc.,

10. Determine Evaluation Process: How will you determine if your event is a success? do you measure success by the number of registrants or attendees or is it dependent on you breaking even or raising a target amount in donations?

5.4. Documentation for Conducting Events:

"Documentation is any communicable material that is used to describe, explain or instruct regarding some attributes of an object, system or procedure, such as its parts, assembly, installation, maintenance and use."

For conducting any event in the business or social world, organizer should arrange various documents for the originality of that particular event. Document is an evidence for conducting and completion of the event in successful manner.

i. Contract: This is the paper or document as agreement between organizer of the event and the client, where the client put some conditions and organizer should follow the condition for organizing that particular event. Following documents are essential at the time of organizing event.

ii. AV cue sheet: AV cue sheet means written sheet about Audio Visual team with a detailed cue sheet which help them so succeed.

iii. Budget: It is a document which keeps control over the expenses of the event and gives those saving tips through it.

iv. Celebrity Participation Document: This document makes us understand that who the celebrities are participating in the event. Confirming celebrities at a charity event is something that takes of lot of effort, and follow-up. This one-sheet will make the event manager's job easier.

v. Master Spreadsheet: It is also called Conference Management Tool. If event manager wants to keep track of hundreds of guests for an upcoming corporate event than he should prepare one master spread-sheet in which he as the liberty to add or delete the columns asper the event and the column required.

vi. Conference Timeline: Every event includes sub events where the timeline should be followed by the event manager. This timeline has to scheduled and followed to make the event success.

vii. Lunch / Dinner Party Budget: Event manager has certain budget for cooking. It depends on the type of event and client's option and his capacity to spend. Event manager should keep a track on the budget and try to save the expenses.

viii. Event Signage List: Events require clear directional signage – here's a list of basic signs and suggested sizes to include at your next function. Check out the entries on signage under tips by category (above).

ix. Event Summary Form: Once the event is over just a few more hours will ensure event manager to remember what went well, and what to change next time. Event Wrap Ups are also great document to share with the head of marketing executive host and the one who controls the budgets.

x. Event Vendors One Sheet: There are more than one vendors required to manage one event. One list has to be prepared with all vendors' Name, Address, and Mobile number in order to avoid confusion and get them in contact when required. This document should be distributed to all team members who make the work easy.

xi. Menu Card Template: In this document whatever is going to be served at the table is been listed which helps the guest choose their menu. This gives a custom touch to the event. There are hundreds of styles, for e.g., version for a seated dinner that you can print in size 5.5x8.5.

xii. Thank you Note-Card: After the event is over a Thankyou note is deliver at the gate as it is a token of appreciation. It is optional.

xiii. Press Release: Before beginning of the event, event manager should promote that event through the press release. Such events include charity event, leisure events, cultural events organizational events, social events. After the event is over a press note is given to the press in order to conclude the event. For this journalists are invited for important events.

xiv. Tent Rental Card: When looking into an event, tent rental card there are many questions and options including design of the tent. Tent is basically depending on its design complications.

xv. Venue Check List: Selecting a venue is a very important decision, and a difficult one. The venue check list provides ideas to consider so the event manager can select the event venue that best fits yours needs.

xvi. Video Production Cost Savings: Video productions are a critical investment in conferences or in any social or commercial event. Budget is depending on client's attitude and design of the video-maker.

xvii. Wedding Event Budget Tool: Planning a wedding, "the best day of your life", can become a stressful process often due to money. While this wedding budget template won't add funds, it will help you assess all expenses and decide how best to allocate your funds.

5.5. Principles of Event Management:

The following principles are followed by the Event Manager while organizing any one event:

1. Excellent Local Knowledge of the Regions: It is important to help the event manager to choose the most suitable hotels, restaurants and places available to hire for client's event. Their price negotiations and their daily collaboration with the local partners who share their customer service values: seminars hotels, conference centres, restaurants and venues for cocktails parties and evening events.

2. Professional Guarantees: The knowledge about logistic organization, the travel agency license, bank guarantee, professional liability insurance, membership of travel agents and the etc.,

3. Information about Type of Event: Event manager should know the type of the event like seminar or conference, incentive event, tram building activity, executive committee meeting, VIP event or reward trip etc.,

4. Advice and Booking: Of all kinds of accommodation, from luxury five star hotels to high mountain shelters, including castles, seminar hotels and charming backcountry hotels, according to client's objectives and budget has to be done by event manager.

5. Booking of Entertainment Places: Private hire of prestige premises, such as villas, museums, abbeys, Yachts etc., or original places such as a zoo, theme park, castle, observatory, etc., and organization of meals with caterers, festival dinners and evenings, cocktail parties and organized to activities should be considered by the event manager.

6. Hotel Information: Event manager should know managing teams of receptionists, logistical organization of hotel reception and transfers, reception desks in hotels, interpreters booking meeting rooms and the logistics of fitting them out according to clients' specifications.

7. Sports or Recreational Activities: For client incentive or team building programs, event manager should have supervised by qualified guides and instructors. Original activities for non-participating partners, or all participants, including cultural visits in several languages supervised by qualified conference guides, well-being programs and artistic or sports activities containing trainers, actors or sports personalities who can give personal accounts or give coaching talks on themes specifically relating to performance in the business world.

5.6. Check List for Event Manager:

However big or small your event is going to be, planning it will follow the same general pattern and include some common issues.

1. Make sure your objectives are clear:

i. Discuss what you want your event to achieve; will it raise the profile of your group?

ii. Who are you hoping to attract to the event? Will there be activities for a range of different people?

2. Make sure you have plenty of time: Start planning your event well in advance to give yourself enough time to organize everything.

3. Plan out the work and delegate: Working together on a timetable with all the main dates and deadlines on it can help clarify how much work there is to do, and when. You may want to establish a core planning group to organize the event, with additional volunteers to help out on the day. Be clear about what the roles and tasks are, and who is doing what.

Most events are too much work for two or three people. Try to get more people involved by:

- Advertising planning meetings widely.
- Thinking about the timing and location of you planning meeting and asking potential volunteers what suits them best.
- Producing publicity for the event which also serves as an appeal for volunteers.

4. Practical considerations:

i. Health and safety: Take care to do what you can to avoid accident and injuries at you event. It is useful to conduct a risk assessment, to help make sure you have thought things through systematically. See our information on health and safety for community groups.

ii. First aid: Decide who will be responsible for first aid on the day. For large events, you could ask first aid organizations to attend. Even if you are just using your own volunteers, you need to have a visible first aid point at the event and people who are taking the role of first aiders.

iii. Transport: Make sure your publicity gives details of public transport and parking. Will you need to put up signs in the surrounding streets to make the event easier to find?

iv. Access: You should do what you can to ensure that disabled people can take part in your event. For example, if possible, choose a venue which is accessible for wheelchair users.

v. Children's activities: If you plan to have children's activities, be clear in your publicity whether you are providing care for unsupervised children, or whether children need to bring an adult to look after them. If you plan to provide childcare, you may find it useful to look at our information on running a crèche.

vi. Photography: Do you want or need to photograph or film your event? You should put up signs informing people if they might be photographed, and you should gain parental consent before photographing children. Have a look at out information on photo consent.

vii. Insurance: Consider whether you want to take out public liability insurance.

5. Bookings, permissions and licenses: Make sure the venue is booked and confirmed. Think about what equipment you will need to hire. Check with entertainers / speakers what they expect you to provide. Find out about the regulations for that venue / space early on it can take months for some licenses to be granted. You may need to consider.

- Temporary event notice
- Street collection licence
- Road closure permit
- Permission to use public land

6. Make a budget for the event: Take into account all your costs, so that you don't end up with nasty surprises along the way. For example, venue, publicity, hire of equipment, transport, prizes, insurance, first aid, etc.,

7. Publicity:

- Who do you want your publicity to reach? Think about where those people are most likely to see your publicity and what will attract them to the event.
- How will the posters and leaflets be distributed? Who will do it?
- Will you be using social media? You could set up an event on Facebook and invite people to it. You could also use Twitter to send out reminders about your event in the weeks and days running up to it.

It is the best to get publicity out early, even if this means that it can't include all the final details of the event. You might want to do one piece of publicity as early as possible, which includes the date of the event and basic information about it and another closer to the time, which includes more detailed information.

8. Plan Detail: Shortly before the event, you need to run through the day in detail:

- Where will everybody be on the day? What will each person be responsible for doing?
- Are all the jobs covered, or do you need to do a last-minute ring round to fill some gaps?
- Have you set up all admin (forms / paperwork) that will be needed on the day.
- How will equipment and volunteers get to and from the venue?
- Who is responsible for money on the day?
- Do you have enough time, materials and people for setting up and clearing up?

9. on the day:

- Take photos and record feedback from participants, stallholders and volunteers.
- Give volunteers support and encouragement, and make sure everyone gets a break.
- Keep track of money in and out. Look at your page on managing money at an event for tips and templates.

10. Afterwards: If you've organized a fundraising event with different stall, you might want to takings from the different stalls separately, so that you know which activities made money and which didn't so well. This will help you make a more accurate budget for your next event. Remember to thank your volunteers and helpers, and report back to and thank funders, sponsors, etc.,

It's always worth having a brief discussion with your group after an event is over, to talk through what went well and badly on the day, and draw lessons for future events.

5.7. Tips for Organizing an Event:

A successful event is productive, generates new ideas and strengthens cooperation. Check out our tips for organizing an event that everyone leaves with a smile on their face.

1. Timing: When deciding on the date, consider the time of the year, holiday seasons and competing events. Check the diaries of all key people and start organizing well in advance.

2. The Nature, Theme and Duration of the Event: Consider if the objectives could be reached arranging a daytime meeting or whether it is necessary to organize a two-day seminar with accompanying entertainment. Also, think about the possibility of arranging a video conference so that the parties would not need to attend the meeting in person. It is economical and eco-friendly.

3. Budget: Determine how much money is available for the event before arranging any details. Remember to stick to the budget throughout the project.

4. Number of Participants: Consider carefully who should attend the event. When deciding on the numbers, take into account the people in charge of various sectors, guests as well as the chair and secretary.

5. Guests: It may be unnecessary for all guests, specialists or speakers to stay at the event for its entire duration. Inform the guests of schedule for speeches and all practicalities clearly well in advance.

6. Choosing the Venue: The venue must be comfortable and easy to reach. When choosing the venue, consider its size, the nature of the event, the technology required and the table set-up style. For example, U-shape set-up creates a different atmosphere than a classroom style.

7. The Program: Provide participants with the programmed and agenda in advance. Ask them to comment on these before the event to ensure that all essential issues are covered.

8. Invitations and Registration: Include all practicalities regarding the event in the invitation and attack a map with directions. If participants arrive from different parts of the country, the invitation should be sent out at least a month before the event.

9. Venue and Equipment: Find out what technical equipment the speakers will need, such as audio equipment and projectors. Test the equipment an hour before the meeting starts. Make sure there are clear signs to guide the participants to the right venue.

10. Accommodation and Transportation: Make reservations well in advance so that organizer can book a sufficient number of hotels rooms of the same standard. If necessary, arrange for a coach, organize carpools or send participants instructions for using public transport. Remember to offer information about parking arrangement and possible parking fees.

11. Decoration: Find out if the venue should be decorated for the event with flowers, flags, roll-up banners, posters or other suitable decorations.

12. Social Media: Depending on the nature of the event, take photos of people, notes and decisions and share them within the company through internal channels. (e.g., Intranet, Yammer) or with other partners through social media.

13. Entertainment and Activities: Consider if the event would benefit for entertainment and recreational activities that would help the participants to concentrate. For example, the programmed would include an evening event to support the event theme, and brisk walk in the fresh air or short breaks for exercise could help to keep people focused.

14. Summary and Feedback: At the end of the event, collect feedback from all participants using a feedback form. Then the participants and explain what measures will be taken after the meeting. The organizer could also send them a brief list of the most important decisions and ideas that were brought up in the meeting.

Short answer type questions:

1. Define event management?
2. Mention any four types of events?
3. What is the importance of event management?
4. What is the need of documentation?

Long answer type questions:

1. Explain the types of events?
2. What are the documents required for conducting an event?

3 List out the principles of event management.

4. Mention the tips for organizing an event.

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UNIT – VI

CUSTOMER RELATIONSHIP MANAGEMENT

Introduction - Steps in CRM - Duties and Responsibilities of Customer Service – Associate - Customer Retention Strategies - Handling Customer Grievances

Learning Objectives:

After studying this unit, the student will be able to-

- Understand the need of CRM
- Aware of the duties and responsibilities of customer service associate
- Know how to handle the customer grievances

Introduction:

Companies today are facing tough completion. Consumers are becoming more demanding and their expectations in terms of quality are much high than before. Customers have so many options, that keeping them satisfied has become a core business concern. Companies know that in order to succeed, and even survive, in fiercely competitive markets, they have to adopt a customer-oriented philosophy. In designing their market strategies, they must therefore focus on customer developments and on delivering superior value to customers.

At the present time, in order to beat their competitors, companies need to focus on creating, maintaining and enhancing strong customer relationships. They must pay very close attention to developing stronger bonds and loyalty with their customers. Customer churn (defection rate) involves higher costs, therefore market leaders are trying hard to retain their customers and build customer relationship management programs. The cost of attracting new customer is on the increase and companies are very aware that it can cost up to five times more to attract a new customer than to keep an exiting one happy.

Definitions: CRM is the process of managing all aspects of interaction a company has with its customers, including prospecting, sales and service. CRM applications attempt to provide insight into and improve the company/customer relationship by combining all these views of customer interaction into one picture.

CRM is an integrated approach to identifying, acquiring and retaining customers. By enabling organizations to manage and coordinate customer interactions across multiple channels, departments, lines of business and geographies, CRM helps organizations maximize the value of every customer interaction and drive superior corporate performance.

6.1. Importance of CRM:

Looking at some broader perspectives given as below we can easily determine why a CRM System is always important for an organization:

1. A CRM system consists of a historical view and analysis of all the acquired or to be acquired customers. This helps in reduced searching and correlating customers and to foresee customer needs effectively and increase business.

2. CRM contains each and every bit of details of a customer, hence it is very easy to track a customer accordingly and can be used to determine which customer can be profitable and which not.

3. In CRM system, customers are grouped according to different aspects according to the type of business they do or according to physical location and are allocated to different customer managers often called as account managers. This helps in focusing and concentrating on each and every customer separately.

4. All the details in CRM system is kept centralized which is available anytime on fingertips.

This reduces the method time and increases productivity.

5. Efficiently handling all the purchasers and providing them what they really need increases

the customer satisfaction. This will increase the prospect of getting the customer satisfaction. This increases the prospect of getting more business which ultimately enhances turnover and profit.

6. If the customer is satisfied they will always be loyal to you and will remain in business forever resulting in increasing customer base and ultimately enhancing net growth of business.

7. A CRM system is not only used to deal with the existing customers but is also useful in acquiring new customers. The process first starts with identifying a customer and maintaining all the corresponding details into the CRM system which is also called an ‘Opportunity of Business’.

6.2. CRM Process:

The formation process of CRM refers to the decisions regarding initiation of relational activities for a firm with regard to a specific group of customers or to an individual customer with whom the company wishes to engage in a very or collaborative relationship.

It is important that a company be able to identify and differentiate individual customers. In the formation process, there are three important decision areas: defining the purpose (or objectives) of engaging in CRM; selecting parties (or customer partners) for appropriate CRM programs; and developing programs (or relational activity schemes) for relationship engagement with the customer.

6.3. Process of the CRM:

1. Raise Brand Awareness: The first step on how to introduce prospective clients into your (the) business is by building brand awareness through effective marketing campaigns; to start this step, customer service associate should segment audiences by analyzing their consuming habits and qualities, such as: Age, Gender, Hobbies, Salary etc., In order to understand them and have a **clear perspective** on their likes and needs to captivate them when making the first appearance.

2. Engage the audience: Following a marketing campaign, the engagement part can and must be made via all communication channels in a unified way: mail, SMS, email, telephone, social networks, etc., however, being multi-channel does not mean replicating the communication on all media, it is a question of adapting one's communication according to the different spaces of exchange.

3. Converse: This is the step where the manufacturer actually sees the profits of an effective CRM approach; the purpose of this step is to **convert** an audience or lead to an **actual client.** For this step, customer service associate must be very cautious and do extensive research on future clients, in order to offer a quality service.

4. Provide quality customer service: This is the step where customer service associate should really use CRM as a motto instead of a function; after the conversion period where clients received their goods or services, it is of extreme importance to know the client’s user experience in order to optimize customer service associate offer and understand what changes to make for improved customer experience**.**

5. Invest in Loyalty and Upgrading: Finally, the key step in the CRM process is the support to provide the customers. By definition, customer relations are cyclical: customer service associate objective is to reduce the attrition rate (loss of customers) to a minimum by offering customer support, when it is responsive and when requests are well managed it can be a strong brand loyalty factor**,** making the customer feel valued and grateful for the special attention you've given them.

In addition to retaining customers for increasing profits, another way is to focus on upgrading their purchasing order by switching their shopping habits to more luxury products or services**.** This way offering by the users is a unique and valued experience while **i**ncreasing customer spending**.**

6.4. Duties and Responsibilities of a Customer Service Associate

Some of the duties and responsibilities of a customer service associate is as under:

1. Effectively manage incoming calls, electronic and written inquiries regarding orders and service and ensure prompt, courteous and accurate responses.
2. Dispatches and communicates with drivers to ensure prompt, courteous service.
3. Identify and assess customers' needs to get customer satisfaction
4. Investigate customer complaints; provide appropriate solutions and alternatives and follow-up on resolutions.
5. Obtain and evaluate all relevant information to handle waste, recycling, organics and other service inquires.
6. Communicate in a professional and courteous manner with customers and co-workers either by telephone, electronically or in person.
7. Organize workflow to meet department and customer time frames.
8. Handle calls from difficult customers in a professional manner.
9. Keep records of customer interactions and transactions.
10. Record details of inquiries, comments, complaints and actions taken.
11. Communicate and coordinate with internal departments.
12. Follow policies, procedures, and guidelines.
13. Provide feedback on the efficiency of the customer service process.
14. Work closely with co-workers in a team environment.

6.5. Customer Retention Strategies:

6.5.1. Customer Retention:

Customer Retention can be defined as the possibility of a client to be retained by the organization considers customer retention as maintaining customers for life. The life span worth of a customer to any business can be appreciated in their financial performance. Some studies considered Customer retention from a behavioral perspective. Thus, the customer feeling belong and dedicated to the company. For instance, the customer recommends the company to others and willing to repurchase services or products from the organization.

6.5.2. Customer Retention Strategies:

The best customer retention strategies are formed around business goals and insights. The following are the customer retention strategies that actually work and can boost your retention stats.

1. Surprise Gifts and Discounts: Customers are people and people love to feel appreciated. One-way customer service associate can show his customers that he appreciates them is through surprise gifts and discounts. He can offer them a discount on products they frequently purchase, along with a short and sweet message from the customer service team telling them why they are receiving the surprise. Offering surprise gifts and discounts not only encourages customers to buy again, but it can also elevate his brand. Customers who receive surprise gifts often post them to social media, increasing the exposure which can help attract new customers to the business.

2. Provide Excellent Customer Service: This may seem a little obvious at first glance, but you (customer service associate) need to consider what a company considers excellent customer service does not always match up with what the customer thinks are excellent customer service. There’s often a huge gap in perception

Here are a couple of ways customer service associate can boost his customer service to the next level:

i. Provide multiple contact channels to accommodate a range of communication preferences.
ii. Route the right agents to the right customers by assessing the customer’s needs and assigning the agent most skilled in that area.

3. Customer Surveys: Send the customers a quick online survey to complete to gain a better insight into what’s working, and what isn’t. He will never please every customer on every issue, but surveys can help to identify patterns that he has missed. A good survey should have a mixture of multiple-choice questions and free text answer fields to allow the customer to express their opinions more thoroughly where needed. Design a strategy for the survey.

4. Keep Customers Informed: Make customers feel a part of the wider team by keeping them up to date on new developments such as new product lines, new partnerships, or exciting milestones for the company. Customer service associate can do this through a monthly newsletter over email.

5. Customer On boarding: On boarding will vary depending on the company's niche, but the aim is to educate a customer about a company's products and the brand. Customer service associate do not want to overwhelm them with a wall of text about his business philosophy but being too quiet can make the customer feel ignored. When a customer buys one of the products, customer service associate can send them an email with a short tutorial on how to use it and the details of the customer service team, so they know who to contact if they have any issues.

6. Use Gamification: Gamification is a fun way to reward loyal customers for benefitting your company, and it's a very successful strategy. Customer service associate can offer customers a discount for referring a friend, he can award them redeemable points for each purchase, or you he can give them a visual appreciation boost in the form of a badge.

7. Be Personal: Customer service associate are collecting lots of data on from his customers, so use this data to improve their experience. Before reaching out to a customer he should know how they like to be contacted, what they have bought previously, and what previous interactions looked like. Customer's do not want to feel like just another number, and they will become frustrated if they have to repeat the same information over and over.

6.6. Customer Grievances:

Customer grievance can be defined as the gaps between what business promises in terms of the product or services and what customers get. It is a mismatch between how customers perceive the brand and where they fail to get the desired customer service experience.

There could be different types of customer grievances. It could be related to

a) improper communication

b) internal processes

c) poor quality of service

6.6.1. Benefits of Customer Grievances:

Some key advantages of customer complaints are:

i. Complaints highlight key areas where the products or services need improvement.

ii. Customer complaints open opportunities for the sales team to have honest discussions with the customers. These conversations can help customers feel like the vital components to salesman success.

iii. Customer complaints provide valuable insights into how trained the front line support is and how to improve them. They can be used as training models for new team members.

6.6.2. Handling Customer Grievances:

Once you (customer service associate) have developed a policy he/she can create a procedure for handling complaints. A procedure will ensure complaints are dealt with the same way, every time. The procedure should be easy to understand and follow by his/her staff.

Customer grievances procedure could include the following steps.

1. Listen to the complaint: Thank the customer for bringing the matter to your attention. Apologize and accept ownership, don't blame others and remain courteous.

2. Record details of the complaint: Go through the complaint in detail to understand exactly what the problem is. Keep records of all complaints in one central place or register. This will help to identify any trends or issues.

3. Get all the facts: Check he have understood and recorded the details of the complaint correctly. Ask questions if necessary.

4. Discuss options for fixing the problem: Ask the customer what response they are seeking; it could be a repair, replacement, refund or apology. Decide if the request is reasonable.

5. Act quickly: Aim to resolve the complaint quickly. If it takes a long time they tend to escalate.

6. Keep the promises: Keep the customer informed if there are any delays in resolving their request. Do not promise things that he cannot deliver.

7. Follow up: Contact the customer to find out if they were satisfied with how their complaint was handled. Let them know what you are doing to avoid the problem in the future.

Make sure staff is trained to follow all the procedure when handling complaints and that they have the power to resolve issues as quickly as possible.

Encourage his customers to provide feedback and complaints so that they let him know when there is a problem and give you the opportunity to resolve it.

6.7. Who Uses CRM Software?

Marketers, salespeople, and customer service professionals require different utilities of a CRM system. Let's look at how CRM is useful to each one of them:

1. Marketers: Marketers collect customer data from multiple sources, such as lead generation forms, surveys, social media, etc. By integrating the CRM system with a MAP, marketers can supercharge marketing efforts through drip marketing campaigns, social media ad campaigns, and so on.

2. Salespeople: Salespeople are always on their toes needing to communicate with every prospect and customer on a 1-on-1 basis. A CRM tool provides a central repository where they can get to know their customers at greater depth, profile them as hot/warm/cold leads and create real-time sales reports that give them a quick overview of the sales performance.

3. Customer Service Professionals: By integrating the customer support application with the CRM, you get a composite view of your customers and enables customer service executives proactively solve customer queries. The use of social CRM allows them to communicate with customers via social media, calls, text, chat, etc.,

Short answer type questions:

1. Define CRM?
2. What is CRM process?
3. What is customer grievance?
4. What are the benefits of customer grievances?
5. Who are the users of CRM software?

Long answer type questions:

1. Discuss the importance of CRM?
2. Write the steps in CRM?
3. Explain the duties and responsibilities of a Customer Service Associate?
4. Elucidate about Customer Retention Strategies?
5. How to handle customer grievances?

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UNIT – VII

SALES PRESENTATION

Planning for sales presentation - Objectives and techniques of sales presentation - Steps in sales presentation - Introduction of product, its features and benefits – Objections.

Learning Objectives:

After studying this unit, the student will be able to-

- Know the planning for sales presentation
- Acquaint the knowledge on process of sales presentation
- Understand the reasons for objections

5.0. Introduction:

In sales technique, a sales presentation is a line of talk that attempts to persuade someone or something, with a planned strategy of a product or service designed to initiate and close a sale of the product or service. It is essentially designed to be either an introduction of a product or service to an audience who knows nothing about it, or a descriptive expansion of a product or service that an audience has already expressed interest in.

7.1. Planning for sales presentation:

A sale planning is an activity, or a set of activities designed to begin the salesperson to move towards achieving his or her goals. Effective planning requires the salesperson to put in a lot of thought, effort and hard work, but the effort is worth it in the long run. I want to demonstrate to you, in this book, that planning is simple and can be easily built into your routine.

With careful planning, sales professional has a much clearer vision of what he need to accomplish and a roadmap for how to get there. Unfortunately, many sales professionals have never been taught to create a comprehensive sales plan. The good news is that the process is relatively simple. Here are seven steps you can take to create an effective sales plan:

1. Define the objective: Clearly outlining a goal should always be sales professional first step in planning a sales call or any other business endeavor. Is the purpose to establish himself as a trusted advisor? Close a specific deal? When defining the key objective, he can plan later steps around achieving it.

2. Evaluate the current situation: Next on the list is an honest assessment of the situation, and it will relate to the goal the sales professional set in the first step. If the sales professional objective is to expand his relationship with a customer, an evaluation of the current situation would consist of defining his present relationship.

3. List of barriers to success: This step can be one of the most critical to achieving the sales professional goals: Create a detailed account of obstacles to his success. Knowing exactly what he was up against can be incredibly inspirational, sparking new ideas about how he can overcome barriers.

4. Assess the strengths and assets: Take an honest look at the resources and think about how he can apply them to achieve his objective. Strengths and assets can include things like personal relationships, sales kits, competitive advantages like new products and much more.

5. Create the sales call strategy: Using the information, he has compiled in steps one through four, develop his sales plan by outlining how he will reach his goal. Depending on the situation, his plan might include the sale of a specific product and the steps he will use to persuade his prospect.

6. **Identify the needs:** Once sales professional has his basic strategy in place, now is the time to outline what he will need to get the job done. His needs may include items like a sales deck or demo program. Requirements could also include a list of accounts. The important thing is to identify needs upfront.

7. Outline an action plan: The action plan is a companion piece to the sales call strategy described in step five: It is a to-do list of tactical steps he will need to accomplish the strategy. The action plan might include items such as finalizing pricing with his company before he makes the sale.

Sales professionals, perhaps especially those who have been in the business for a while, often neglect to thoroughly plan sales calls, counting on their experience and confidence in their ability to think on their feet to carry them through. And while that strategy may generate adequate results, it doesn’t prepare the sales professional for every contingency and may produce less than stellar returns.

7.2. Objectives and techniques of sales presentation:

In marketing, a presentation may not mean a formal meeting in a conference room. It is any situation when a salesperson prepares information to deliver to one or more customer prospects. Presentations can be delivered one-on-one in the prospect's office, or even by videoconference. By putting thought into the objectives of the presentation, the salesperson which in a small business is sometimes the owner has a better chance of closing the sale.

1. Create excitement: Maintain an energetic tone throughout the presentation. Use humor although sparingly to keep the audience engaged. Express why the sales person is passionate about his company's products or services.

2. Clearly explain about the product benefits: Whenever possible, express the benefits in s terms such as the money or time the customer will save by using them. Include the customer with in the presentation by showing him how he specifically will benefit the problem that you can solve for him or the need your products or services can fill.

3. Differentiate his products from competitors' product: Show the customer prospect how the offering is clearly superior to what competitors are offering. Avoid making negative or derogatory comments about competitors. Focus on the positives about his company products and services.

4. Emphasize the most important themes: As the salesman prepare his presentation, if you he finds it is running too long, think about what key points he especially wants the prospect to remember and make sure that he includes all of those.

5. Build credibility and trust: Avoid making exaggerated claims that cannot be backed up with facts. Express that he understands the customer's problems or needs and is there to help him and not just sell to him.

6. Anticipate customers' questions in advance: Salesman has to anticipate customers' questions in advance and answer them in the presentation. Think about objections the salesman had to overcome in prior presentations and how he addressed them satisfactorily. Make sure to allow plenty of time for customers to ask questions during or after the sales presentation.

7. Progress steadily toward a sale: A presentation can be considered successful even if the sales man does not close the sale at that time. His goal is to create an ongoing dialogue with the customer prospect. Set up a time for a follow-up meeting or phone call. Offer to send or email additional product literature to address questions they may have expressed. Make sure he closes the presentation with the suggested next step.

7.3. Steps in sales presentation:

Professional selling involves a series of seven distinct steps they are:

1. Prospecting
2. Preparation
3. Approach
4. Presentation
5. Handling objection
6. Closing the sale
7. Follow-up

1. Prospecting: Prospecting is finding and qualifying potential customers. Qualifying is the process of determining whether a potential customer has a need or want that the company can fulfil, and whether the potential client can afford the product.

2. Preparation: It involves preparing for the initial contact with a potential customer. Salesman will need to collect and study relevant information, such as product descriptions, prices, and competitor information. He will also need to develop his initial sales presentation.

3. Approach: In this step, the salesman has his first face-to-face interaction with the potential customer. In the premium approach, salesman gives his prospect a gift at the beginning of the interaction. It may be a pen, a novelty item or company calendar etc., The idea behind these approach is to get the prospect involved in the interaction quickly.

4. Presentation: It is actively listening to the needs and wants of the potential customer and demonstrating how the product can meet those needs and wants.

5. Handling objections: Objections can be useful because they tell the salesperson what to focus upon in addressing a prospect's concerns. Successful salespeople learn how to overcome objections through preparation and having the right information at hand to address them.

6. Closing: It involves identifying closing signals from the prospect that indicate its decision time. There are different approaches to closing. In the alternative choice close, salesman assume the sale and offer the prospect a choice such as, 'Will this be a cash or credit transaction? An extra inducement close involves salesman offering something extra to get the buyer to agree, such as a discount or a free product. In the standing room only close, he informs the prospect that time is of the essence because some impending event, such as a price increase, will change the terms of the offer.

7. Follow-up: Follow-up is a building a long-term relationship with the customer for purposes of repeat sales. For example, salesman makes contact with the customer sometime after the sale and make sure the product was received and is in good condition. Again, the idea is not to sell at this stage, but to create a solid relationship for future sales.

7.4. Introduction of product:

The term Product is mostly used as a need-satisfying entity. It represents solution to customers, problems. In the words of Peter Drucker, the product remains mere raw material or at the best an intermediate till it is not bought or consumed. Hence mostly they comprise of both tangible and intangible benefits. It may be anything that can be offered to a market to satisfy a want or need and include physical goods, services, experiences, events, places, properties, organization, information and ideas. In most of the cases products are made up a combination of physical elements and series. It is observed that consumers buy products or services that they require to fulfil their needs. The products could range from tooth brush, chocolates, cars, movie tickets to life insurance at various stages of our life. The decision to make a purchase is hence dependent not only on the tangible attributes of the product but also on the psychological attributes like brand, package, warranty, image or service to name a few. According to Philip Kotler, “Product is anything that can be offered to someone to satisfy a need or a want”.

William Stanton, “Product is a complex of tangible and intangible attributes, including packaging, colour, price, prestige and services that satisfy needs and wants of people”. It is defined as a good or service that most closely meets the requirements of a particular market and yields enough profit to justify its continued existence

7.4.1. Components of a Product:

Products have their own identity or a personality. Most of the user associate meaning with products, they obtain satisfaction by using them. The various features and functions built around them-the brand name, the package and labelling, the quality associated with it, the guarantees, the price, the manufacturer’s name and prestige-all contribute to the personality or the total product offering, a marketer’s armory for satisfying the customer. It has been often stated that a customer never just purchases the generic product but he procures something that exceeds his expectation depending on for which it is being bought. The components of the product include core product, associated features, brand name, logo, package and label.

7.4.2. Features of the product:

Features of Product: Not withstanding variations in the emphasis and focus in the above definitions, the consensus of opinion about the meaning of the term product converges on some points. These points may be referred to as the essential features of product. These are briefly described here.

1. Tangible attributes: To be called a product, an item should have the characteristic of tangibility. It means it may be touched, seen, and its physical presence felt as, for example, an automobile, scooter, pressure cooker, shaving cream, toothpaste, etc.

2. Intangible attributes: Alternatively, it may be intangible in the form of a service for example, repairing, hair-dressing, banking or insurance services. These services may be bought independently/exclusively or may be associated with tangible products.

3. Peripheral or associated attributes: Product may have peripheral or associated attributes to facilitate its identification and acceptance by buyers. Such attributes may be a brand, package, warranty, credit and delivery terms. By and large, brand and package are such attributes which are common to many products. For example, Hindustan Levers Vanaspati ghee has a brand name DALDA and its package exhibits a conspicuous palm tree with which it has come to be identified by consumers. Its brand name has developed such an image in the market that all kinds of Vanaspati ghee that being sold is often referred to as Dalda ghee; it has become a generic name for all types of Vanaspati ghee.

4. Exchange value: For marketing purposes, every product, whether tangible or intangible, should have an exchange value and should be capable of being exchanged between buyer and seller for a mutually agreed or acceptable consideration.

5. Consumer satisfaction: From the marketing viewpoint products should have the ability to deliver value satisfaction to consumers for whom these are intended. This satisfaction may be both real/and or psychological. For example, when a housewife buys a talcum powder she not only buys a chemical compound having some tangible features but also buys beauty. The former may deliver a real value but the psychological value is delivered by the latter

6. Business need satisfaction: In order to be a product, an item should also have the attribute of satisfying a business need. The basic business need obviously is to earn profit on the product sold. However, it may be to meet a societal need also. For example, cholesterol-free edible oil product may satisfy a societal need; it may or may not generate profit. The test is, therefore, not whether it generates profit or not, but whether it has that attribute of generating profit or not. After having described the essential features of the term product, it may be defined as a set of tangible, intangible and associated attributes capable of being exchanged for a value with ability to satisfy consumer and business need(s).

7.4.3. Benefits of the product:

Product benefits are the things a product offers to satisfy the needs, desires and wants of a consumer. They are what a consumer hopes to get, feel or achieve when he/she uses a product. Product benefits can either be actual or perceived. Perceived benefits include the products popularity, its image or its reputation.

i. Benefits of marketing products: Marketing products includes conducting product and customer research, promoting products to targeted customers, providing service and following up on customer experiences. Companies that engage in product marketing typically have a greater potential to attract customers, improve products through research and development and garner long-term loyalty.

ii. Knowledge: Specific to the research element, product marketing helps companies improve their awareness and understanding of product potential and customer desires. Product research is used to identify new and emerging technologies or materials used in product manufacturing. Consumer research is used to understand the particular product traits and benefits that core customer segments desire. This knowledge allows for focused product development and more impacting promotional messages.

iii. Present Benefits: The promotional phase of marketing includes the use of paid advertising, public relations and selling to communicate product benefits and value to targeted customers. This is a critical benefit of marketing, because you can explain to customers through promotional messages why your brand's product is distinct, different and better than competitor offerings. Without promotion, you may have the best product available, but customers won't know. Thus, developing a product concept, or understanding of your most unique product benefits, helps you sell your brand to customers.

iv. Attract New Customers: When companies add new features and benefits to products over time, promotion may also help attract new types of customers. Fast-food hamburger shops began adding salads and healthier menu options in response to emergence of fresh sandwich shops promoting health benefits. Adding healthier options helped attract customers who otherwise would have no interest in less-healthy burgers and fries. Adding new customers means new revenue sources.

v. Greater Product Demand: One of the more basic but critical benefits of marketing products is increased demand. When you develop products that meet the needs and desires of customers, as well as attract new customers, you create greater demand for products. As a manufacturer, this allows you to produce more products and generate more revenue. As a reseller, greater product demand may allow you to buy in greater bulk from suppliers, possibly getting volume discounts.

7.5. Objections and types of objections:

An objection expresses disapproval of action. The salesman carries on the sales talk. He thinks he has created the desire. But the prospect is still undecided. Customers rarely concede without raising objections and getting them classified. Objections must be met tactfully and to the full satisfaction of the customers. Objections may arise due to ignorance, fear, misunderstand of the sales talk, the answer can be postponed after taking the customer into confidence.

7.6.1. Way of expressing objections:

i. Remaining undecided;

ii. Advancing false pleas;

iii. Frankly disclosing genuine objections.

(i) **Remaining undecided:** The prospect listens patiently to the sales talks but still remains unmoved. He remains in a state of indecision. He feels as if he can reply neither in the affirmative nor in the negative.

(ii) **Advancing False Pleas:** The prospect does not remain in silent listener but speaks out. He advances some plea or excuse as if he is trying to get out. He may feel that sales are putting unnecessary pressure. To him the quality of the prospect may look inferior. But he has not the boldness to tell openly his mind and displease the salesman. He feels shy to open his mind.

(iii) **Frankly disclosing genuine objections:** In this case the prospect clearly comes out to state his genuine objections. He intends neither offending the salesman nor tries to evade. The objection may to be the price or the quality of the goods. He simply says, thankyou gentleman, I am sorry, I don’t want the thing. Your terms of sales are not acceptable to me.

7.5.2 Reasons for objections:

(i) Slack Business: Customers often talk of slack business and make it an excuse for not buying. Such an excuse if raised by the customer at the end of the sales talk should mean that it is a mere pretext to postpone the purchase. The salesman should not find it so difficult to convince the customer of the advantage of buying the article immediately. The salesman, should have already with him a plan to promote the customer's sales with the help of the goods he sells and should produce it before the customer raises the 'slack business 'objection.

(ii) Consulting his associates: The customer often desires to discuss the product with his business partner or other associates before he takes the final decision. Usually, the customer puts forth such a plea only often he himself is convinced about the usefulness of the product but does not feel confident to make a purchase. In such cases the salesman may try to feather the variety of the customer and tactfully persuade him to act on his own decision. If he still insists on consulting his associate, the salesman should make it a point to meet both of them once again to present his goods. The salesman must himself commence other associate so as to obtain their consent.

(iii) Postponing purchase: The customer often asks for time to think. It may be a valid objection or may be more excuse. In any case the salesman should not agree to a future sale. He should convince the customer of the immense benefit of buying the product immediately. He should present a story of some on who lost good business in postponing purchases.

(iv) Not Interested: If the customer tells the salesman that he is not interested in the product. the salesman may ask him a straight question "why"? The customer may give reasons which the salesman should answer intelligently and properly. He can restart his sales story in a new way if the person's versions of the talk had failed to arouse sufficient interest in him.

(v) Price objection: The customer may complain of the high price of the goods. It is essential to bring the price factor into discussion immediately after the value of the product is described. It is easy to impress upon the customer the unique qualities and outstanding features of the product to justify its high price. If the customer says, "I can't pay". The salesman can suggest several solutions. He may say:" Sir, who wants you to pay just now? To good customers like you I always give credit. Money may be paid in due course. If you don't like to pay all at one time, pay us and when you place an order on the basis of your six monthly requirements for this you need not pay all at once. Out of the ordered quantity I will supply you what even you want and you have to pay for what much one. During all these six months the same price will charged even if market price goes up substantially.

(vi) Poor quality: Where such an objection is raised, the quality must be proved by comparing it with that of the competitors, producing laboratory reports, opinions of the experts etc., and demonstrating once again to satisfaction to the customer.

Immediately after the objections are met, the salesman waits for the reaction or response of the customer to the proposition placed before him. If the buying decision is realized to be unfavorable, a tactful salesman does not get disappoint. At this point he will at one take them next step and tray his cards again. But then the techniques he employs, at this, reaction point are different.

7.5.3 Methods of handling objections:

The common techniques used to meet objections are as follows:

1. The Direct Denial Method: Normally a salesman should not contradict the prospect. But when the prospect just makes a false statement (e.g., the woolen cloth is a mixture of cotton and wool), the salesman can submit a proof that it is 100 percent wool. But direct denial should be polite.

2. The Indirect Method: Most buyers do not like a flat contradiction. Therefore, the salesman may stoop to conquer. He diplomatically side-steps by saying "what you say is true in many cases but in this particulars case" etc.,

3. The Boomerang Method: In this method, the objection hurled by the prospect returns to him in the form of a reason why he should buy. For example, the prospect says "I have never used an iPod and the salesman immediately replies that is why you need it". But it should be done with care.

4. The Compensation Method: In this method, the salesman admits the validity of the objection but points out some benefit that will compensate for it. A prospect might object that the wood used in the table is not teak. The salesman agrees but tactfully points out that if it were teak the price would be ten times. The low price compensates for the lower quality.

5. The Question Method: The question form of handling objections may make the prospect answer his own objection. For example, to prospect says "I like the quality but it's too costly". The salesman may replay "Mr. Prospect you always travel executive class. Don't you think the pen you are having is below your status?"

6. Pass-up Method: In some cases, a salesman may just smile and pass off the objection. Alternatively, he may pretend not to have heard the objection and pass on to the next point. But this method justified only in case of flimsy objections.

7. The Yes Method: This method is perhaps most popular for handling an objection. The salesperson agrees with the prospect's objection but then makes a statement that offsets the objection: "yes "Mr. prospect, out prices are slightly higher than our competitors but we use higher quality materials so out product lasts longer and you actually save money in the long run".

8. The Comparison Method: In this technique, the salesperson compares it with something that is acceptable: "Mr. prospect its per day cost is less than what you spend on the daily newspaper."

Short answer type questions:

1. What is sales presentation?
2. Explain sales planning?
3. What is meant by objection?
4. What are the ways in expressing objections?
5. Define Product?

Long answer type questions:

1. Write about planning for sales presentation?
2. Explain the steps in sales presentation?
3. List out the reasons for objections?
4. Discuss the methods of handling objections?
5. Write the features of product?

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UNIT – VIII

SPECIALIZED CATEGORIES OF SALESMAN

Auction salesman - Insurance agent - Real estate dealer -. Export salesman - Service salesman - Mail order salesman - Door-to-door salesman - Health care agent.

Learning Objectives:

After studying this unit, the student will be able to-

- Know the role of insurance Agent
- Understand the duties of Real estate dealer
- Acquaint the knowledge on various salesmen and their role in the promotion of Business

8.1. Auction salesman:

An auction sale is the sale of goods through a bidding process and is covered under the Sale of Goods Act, 1930. The process of sale by auction involves the selling of any goods and property of value, in a public gathering where buyers make a bid for the purchase and the sale is made to the highest bidder. Let us understand in detail an auction sale, parties involved, and their rights and obligations.

8.1.2. Rules of an Auction Sale:

Section 64 of the Sale of Goods Act states the rules applicable in case of an auction sale.

i. Sale of Goods in Lots: When the auction involves the sale of goods in different lots, each lot of goods are covered under a separate contract of sale.

ii. Sale Completion: An auction sale is deemed to be complete when the auctioneer says so. The same can be done by the fall of the hammer or any other means used to signify the completion of the sale. The bidder can withdraw the bid anytime before the completion of the sale is declared.

iii. The Right to Bid Reserved for the Seller: The seller can reserve his right to bid at the auction but he must expressively reserve this right. He can appoint an agent to bid on his behalf.

iv. Notification of the Right to Bid by the Seller: If the seller has not expressively reserved his right to bid and has not informed about the same, he or his agent is not authorized to bid at the auction. The auctioneer is not entitled to accept any bids made by the seller or his agent if the buyer has not expressed his intent to do so. Any sale that is in contradiction to this rule will be deemed unlawful and fraudulent by the buyer.

v. Reserve Price: The goods for sale at the auction may be subject to a reserve price or an upset price. The auctioneer cannot sell the goods below this price.

vi. Pretend Bidding by the Seller or His Agent: In case the seller or his agent pretend bid for the goods purposely to raise the bid price of the goods, the buyer of the goods has the right to treat the sale as void.

vii. No Credit Sale: The property in an auction cannot be sold on credit or as per his will by the auctioneer. The auctioneer can accept a bill of exchange in an auction sale but only if it has been allowed by the seller.

8.2. Insurance agent:

Insurance plays an important role in sharing the risks of people in an affordable form. It helps the people to quickly recover from damages and losses. Insurance is a defensive measure used against future conditional losses to hedge the possible risks of the future. It is a legal contract that protects a person from contingent risk of losses through financial means and provides a means for individuals and societies to handle some of the risks faced in daily life.

Insurance agent is a person who works for an insurance company and sells the insurance products of this company. An important aspect of working with an agent is that he / she sells insurance products of one company only, and thus is typically not able and not interested to compare prices and features of other products on the market. Agents should not be confused with brokers (or insurance brokers) who are typically able to compare products from several insurance providers.

Typically, an insurance agent receives a salary paid by an insurance company, and he/she can also receive a sales-based commission or bonus.

8.2.1 Role of agents under IRDA regulation:

i. Full information must be provided to the proponent at the point of sale to enable him to decide on the best cover or plan to minimize instances of ‘cooling off ’ by the proponents.

ii. An agent should be well versed in all the plans, the selling points and also be equipped to assess the needs of the clients.

iii. Adherence to the prescribed code of conduct for agents is of crucial importance. Agents must, therefore, familiarize themselves with provisions of the code of conduct.

iv. Agents must provide the office with the accurate information about the prospect for a fair assessment of the risk involved. The agents' confidential report must, therefore, be completed very carefully

v. Agents must also possess adequate knowledge of policy servicing and claim settlement procedures so that the policy holders can be guided correctly.

vi. Submission of proposal forms and proposal deposit to the branch office immediately to avoid delays and to enable the office to take timely decisions.

vii. A leaflet or brochure containing relevant features of the plan that is being sold should be available with the agents.

8.3. Real estate dealer:

A real estate dealer is a person who is in the business of owning real estate for the main purposes of reselling, not for long-term investment purposes. This could include real estate investors or real estate professionals who buy, build, or sell real estate as their primary business.

8.3.1. Real Estate Agent Responsibilities:

i. Generate client leads to buy, sell, and rent a property.
ii. Counsel clients on market conditions, prices, and mortgages.
iii. Develop a competitive market price by comparing properties.
iv. Create lists for real estate sale properties, with information location, features, square footage, etc.
v. Show properties to potential buyers and renters.
vi. Present purchase offers to sellers.
vii. Facilitate negotiations between buyers and sellers.
viii. Review purchase contracts to ensure terms are met.
ix. Promote properties with ads, listings, and open houses.
x. Prepare loyalty contracts, purchase agreements, rental agreements, deeds, and other documents for each real estate transaction.
xi. Maintain your real estate license and knowledge.

8.3.2. Real Estate Agent Requirements:

i. Must be a licensed real estate agent.
ii. Must be in good standing with the local realtor board, or an inactive agent who can immediately move his/her license.
iii. Experience with sales.
iv. Strong interpersonal skills.
v. Good knowledge of the local property.

vi. Possess a valid driver license.

8.4. Export salesman:

An export agent is a firm (or individual) that undertakes most of the exporting activities on behalf of an exporter usually for a commission. A key feature of the traditional export agent is that they never really take ownership of the goods, which always remain under the control of the exporter. The agent thus will do most of the marketing of the principle (i.e. the export firm) and the firm’s products.

8.4.1. Key Responsibilities of an Export Sales Representative:

Export sales representative is the first person who initiates the sales for the organization. They are the first persons to discover the requirements and understand the taste and trends of the customer. Based on this research, they create, develop and implement different marketing action plans that will help in the growth of the organization. Here are some of the key responsibilities that need to be handled by an export sales representative:

1. To conduct surveys and market research to study and analyze the changing needs of the customers
2. To develop plans and strategies by coordinating with the managers to achieve the sales target
3. To ensure that the products are made available to suit the needs of the customer and by adhering to the sales processes designed to improve the sales
4. To keep abreast of the latest developments in the market by studying the competitor's strategies and products, so that the possible threats can be identified and counter attack strategies can be designed
5. To maintain trustworthy professional relationship with the existing as well as the prospective clients
6. To select, analyze and validate the vendor’s requirements and maintain and update the database related to it.

They monitor and keep a track of the performance of various vendors by assessing their sales performance. They conduct meetings to give information regarding the customer's feedback, positive or negative. They recommend improvements in the products so as to enhance the sales of the organization. They keep themselves updated with buying and selling procedures of the firm and recruit service providers and provide them with the necessary training.

8.4.2. Essential Skills of export sales representative:

To be a successful export sales representative, you should have at least some of the following skills:

1. Excellent communication and interpersonal skills to understand the clients' needs and interact with the vendors and the senior management personnel
2. Self-starter, outgoing personality with exceptional selling and negotiating skills to achieve the sales targets ultimately.
3. Ability to research and analyze the trends in the market and take appropriate decisions or suggest recommendations.
4. Proficient in language, where the products are being marketed.
5. Strong presentation skills, positive attitude and ability to work in a target driven environment.
6. Should be result oriented with good business acumen, computer literate with excellent time management and organization skills.

8.5. Service salesman:

A service sales representative sells the services his company offers, reaching his customers over the telephone, in person, and through letter-writing efforts. A service sales representative can work for nearly anyone: A communications company, an upholsterer, a computer engineering firm, or a caterer, to name only a few who has a service (as opposed to a good) to sell. Service Sales Representatives have to be good communicators, persuasive talkers, and excellent listeners. The most important quality of a service sales representative, however, is the ability to sell. Indeed, her pay check depends on it-many service sales representatives' work from a low base salary plus either commissions on sales or a potentially large bonus.

8.5.1. Responsibilities of a Customer Service Salesman:

i. Perform informal and formal needs assessments for each customer to recommend appropriate goods and services
ii. Develop a rapport with customers, demonstrating a friendly and helpful manner to put them at ease.
iii. Maintain a neat and clean appearance to represent a positive image of the company and its brand at all times.
iv. Participate in training and professional development and put new skills to immediate and meaningful use.

v. Foster a positive and pleasant working relationship with members of the customer service sales team.

vi. Familiarize him himself with current information about services and products available for customers.

vii. Accurately record customer demographics, sales orders, or other information digitally or in written form.

viii. Communicate with clients in Spanish or other local languages or refer them to a capable member of the team.

8.6. Mail order salesman:

Mail order sales is a type of indirect selling technique in which a customer will place an order for purchase and the goods will be delivered to his or her home. Orders will normally be placed through a telephone call or a website. Most often, the customer will provide the company with an address for delivery when placing a mail order, which will be a home or business address. However, sometimes a supplier will deliver the product to a nearby retail store where the customer will retrieve it.

Also, a mail order is commonly used when consumers wish to send gifts. In this case, businesses will often send the gift directly to the third party as long as the consumer provides the address.

Catalogues are a very popular type of mail order service. A catalogue is a piece of literature that will contain the products, descriptions, and prices of a business' inventory. A catalogue company will send their publications to a list of consumers who are likely to purchase their products

8.6.1. Advantages of Mail Order Business:

The mail order business offers the following advantages:

1. From the customers' view-points:

(i) The goods which are not readily available in the local markets can be ordered and

received through mail by a customer.

(ii) The customers are benefited as the goods are delivered at their very doors.

(iii) The customers save the time and expense of shopping.

(iv) The customers get tire to arrange for money to be paid till the goods are delivered by mail.

2. From the seller's viewpoints:

(i) The business could be operated from any place where the mailing facilities are available.

(ii) The business could be undertaken even with a small amount of capital.

(iii) The MOB has potentiality to widen the markets and to discover the untapped markets.

(iv) There is no bad debt as the payments are received before delivery.

(v) The establishment and its costs are minimum.

(vi) Prior assembling of goods is not necessary as this can be done as and when the orders are received.

8.6.2. Disadvantages of Mail Order Business:

The mail order suffers from the following disadvantages:

1. From the customers' point of view:

(i) The customers do not get opportunity to inspect and select the goods before purchase.

(ii) The customers do not get credit facilities.

(iii) The customers do not get the goods quickly even when urgent because of order-
processing time at the seller's end.

(iv) After-sales services are out of question.

(v) The customers may not get exact idea about the product characteristics from the printed catalogue.

(vi) Sometimes the goods become damaged in transit causing loss to a customer.

2. From the seller's point of view:

(i) Advertising and publicity expenses may be high with certain products.

(ii) The products requiring demonstration before the customers cannot be sold.

(iii) The seller has to bear the expenses even when the customers do not take delivery of goods by mail.

(iv) Potential but illiterate customers cannot be approached by a seller.

8.7. Door-to-door salesman:

Door to door sales persons are called Direct Sales Representatives. Front desk positions are called Retail Sales Agents.

Door-to-door sales (or D2D) are a direct selling method, a canvassing technique that is commonly used for sales, marketing, advertising, and campaigning. In D2D, sales representative visit potential customers in their homes and convince them to buy products or services.

Selling door-to-door involves several stages:

i. prospecting (a process of searching for new potential customers);
ii. qualifying (or identifying the customer's needs that match your product/service features);
iii. pitching (making an offer and describing its benefits in detail, actually proving that your product solves the customer's problem);1
iv. closing (asking the customer to buy the product or order a service);
v. follow-up (establishing contact with the customer to make sure that he has received the order and any needed support, and that they are satisfied).

In the B2B field, sales reps visit various companies, trying to land an appointment with organizations' decision-makers. B2B sales sometimes involve additional ways of persuasion for example, demos and presentations.

8.8. Health care agent:

A healthcare agent is a person who makes healthcare decisions for someone who cannot make their own decisions. An agent may be needed if the person is very sick, injured, or is nearing the end of their life. All adults are encouraged to choose a healthcare agent before a medical crisis.

A health care agent may also be known as:

i. An attorney-in-fact
ii. A health care proxy
iii. A representative
iv. A surrogate

8.8.1. How to choose health care agent?

i. A health care agent can be any adult. It could be a family member or friend, a lawyer, or perhaps someone from your faith group. In most states, doctor or someone who works for your doctor, hospital, or nursing home can't be chosen as health care agent.

ii. They have to be someone close and trusted. They have to be approachable to talk about hard decisions and have to provide support through choices.

iii. A Health care agent may have to ask doctors a lot of questions and push hard on crucial matters. The chosen health care agent should be able to handle that.

iv. When choosing a health care agent, it's important to talk a lot with each other and be very clear and honest. Because no matter how close someone is, people have very different ideas about what to do in situations like these.

v. It's also essential to talk about values and beliefs. Being clear on life-support decisions are very important, like CPR or a feeding tube and in what circumstances.

Short answer type questions:

1. What is auction sale?
2. Who is insurance agent?
3. Who is real estate dealer?
4. What are the mail order sales?
5. Who is door-to-door salesman?
6. Who is health care agent?

Long answer type questions:

1. Write the rules for auction sale?
2. Explain the role of agents under IRDA regulation?
3. Write the key responsibilities of export sales representative.
4. Explain the responsibilities of a customer service salesman?
5. Discuss the advantage and disadvantages of mail order business?

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1. Salesmanship & Publicity – Dr. Varma and R. K. Aggarwal
2. Principles of Management – R. Sharma
3. AP Intermediate Vocational Retail Management Text Book
4. Advances in Retailing – Class XII, PSSCIVE, NCERT, Bhopal.

MODEL QUESTION PAPER

RETAIL MANAGEMENT

THEORY QUESTION PAPER

IInd YEAR

PAPER –III: RETAIL MANAGEMENT (THEORY)

Time: 3 hours **Marks :50**

SECTION –A

Note: - i) answer all questions **10X2=20**

ii) Each question carries two marks

1. Define retailing
2. Define Mall
3. What is ABC Analysis?
4. Define SCM
5. What is Telemarketing?
6. Define event management
7. What is customer grievance?
8. What is sales presentation?
9. What is means by objection?
10. Who is insurance agent?

Section –B

Note i) answer any five question **5X6=30**

ii) Each question carries six marks

11.Write the functions of retailer?

12. What are the Objectives of Inventory Management?

13. Explain the elements of supply chain management?

14. Explain the 7C's in E-Marketing?

15. List out the principles of event management.

16. Write the steps in CRM?

17. Explain the steps in sales presentation?

18. Explain the responsibilities of a customer service salesman?

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