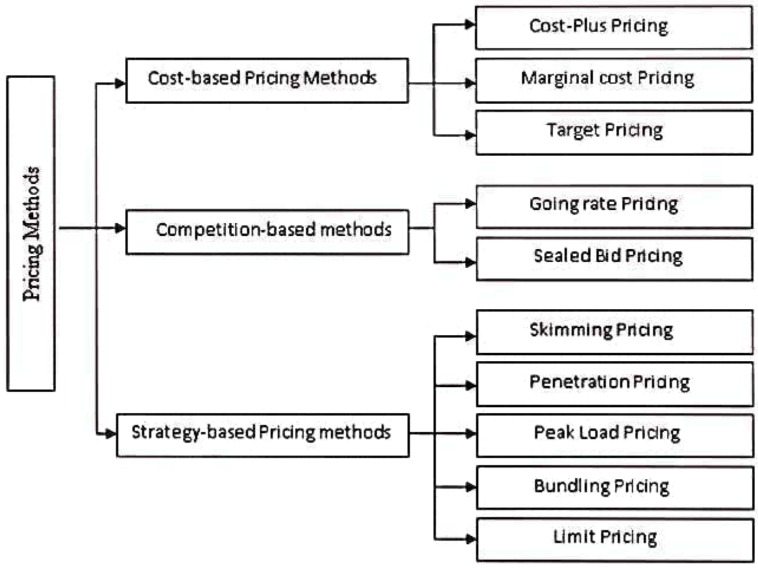
Pricing methods:



A. COST-BASED PRICING METHODS:

1. Cost-Plus Pricing Method: This is also called full-cost or mark-up pricing. Under this method, required margin adds to production cost by using the following formula.

$$\boxed{\text{Mark-up Price} = \frac{d}{1-r}}$$

Where,

d=cost per unit (both fixed & variable)

r=required rate of return.

2. Marginal Cost Pricing: Marginal cost means additional cost to produce an additional unit of product. In this method price of a product determined on the basis of marginal cost or variable cost. Fixed costs are totally ignored.

3. Target Pricing: In this method, the manufacturer considers a pre-determined target rate of return on capital invested. The following formula is used to calculate the desired rate of return.

B. COMPETITION BASED PRICING METHODS:

1. Going rate Pricing: In this method firms adopt a price ruling in the market rather than independently determining the price on their own.

2. Sealed Bid Pricing: This method is more popular in tenders and contracts. To win a contract firm quotes less than the competitors in a sealed cover.

C. STRATEGY BASED PRICING METHODS:

1. Skimming Pricing: When the product is introduced for the first time in the market, the company follows this method. In this method, the companies launching the new product at a higher price. There are two ways of skimming. They are:

i) Rapid skimming Strategy: In this method the marketers launch the new product at a high price and high promotion strategies.

ii) Slow skimming Strategy: : In this method the marketers launch the new product at a high price and low promotion strategies.

2. Penetration Pricing: This is exactly opposite to the market skimming method. In this method, the companies launching the new product at a low price. There are two ways of penetration.

i) Rapid Penetration Strategy: In this method the marketers launch the new product at a low price and high promotion strategies.

ii) Slow Penetration Strategy: In this method the marketers launch the new product at a low price and low promotion strategies.

3. Peak Load Pricing: In this method firms fix higher price during the peak times and low prices in the off-peak times.

4. Bundling Pricing: It refers to the practice of bundling two or more different products together and selling them at a single
bundle price.

5. Limit Pricing: In this method a monopoly firm or oligopoly firms determines prices by collusion in such a way that they do not allow the entry or survival of new competitors.

3

Q7. What is Oligopoly? What are the features of Oligopoly?

Ans:

The term „oligopoly" is derived from the two Greek words „oligos" meaning „<u>a few</u>" and „**pollen**" meaning „<u>to</u>

<u>sell</u>".

Definition:

"Oligopoly is a market structure, in which a few large firms produce either homogeneous or differentiated products and which are close substitutes to each other."

Simply Oligopoly means competition among a few firms. Oligopoly markets can be classified into two categories. They

are:

- Pure Oligopoly Market
- Differentiated Oligopoly Market

<u>Pure Oligopoly:</u> In this market firms producing homogeneous product.

<u>Differentiated Oligopoly:</u> In this market firms producing differenced products, which are close substitutes of each other.

➤ <u>Features of Oligopoly:</u>

1. **Existence of Few Sellers:** There is small number of large sellers supplying either homogeneous products or differentiated products.

2. **Homogeneous or Distinctive Product:** The oligopoly firm may be selling either homogeneous product like steel or distinctive product like automobile-passenger cars.

3. **Blockaded Entry and Exit:** Firms in the oligopoly market face strong restrictions on entry or exit.

4. **Imperfect Dissemination of Information:** Detailed market information relating to cost, price and product quality are usually not published.

5. **Interdependence:** The firms have a high degree of interdependence in their business policies about fixing of price and output determination.

6. **Advertising:** Advertising and selling costs have strategic importance to oligopoly firms. Each firm tries to attract consumers towards its product by incurring excessive expenditure on advertising.

7. **Price Rigidity:** In an oligopolistic market, each firm sticks to its own price. This is because; it is in constant fear of relation from rivals if it reduces the price.

5

PUBLIC SECTOR ENTERPRISES

Q8. Briefly explain about public sector enterprise.

A public sector enterprise is one which is owned, managed and controlled by the central government or state government or any local authority. In a public enterprise, government contributes the whole or major part of the capital. Ex: Postal, Railways, FCI, LIC, BHEL etc.

➢ **Features of Public Sector Enterprises:**

- **Managed by the government:** All public enterprises are owned and managed by the government. Management is either through some department or by appointment of officials.
- **Provision of Public Utilities:** The basis aim of these enterprises is to provide minimum necessities to the citizens at a reasonable price.
- **Implementation of Government Plans:** Economic plans of the government, intended, for the welfare of the people, can be implemented using these enterprises.
- **Large Scale Industries:** Industries, which are of great importance to the public at large and require huge capital investment, are set up in public sector.

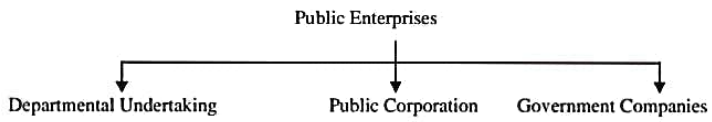
➢ **Need for the Public Enterprises:**

- **Economic Growth:** Economically under developed countries, need public sector to grow and improve the standard of living of their citizens.
- **Creating Employment Opportunities:** By starting these public enterprises, employment can be provided to a large number of people.
- **Utilization of Natural Resources:** Large stocks of natural resources can be better utilized by public enterprises.
- **Government Revenue:** Public enterprise gets a lot of revenue for the government, which can again be utilized for public welfare.
- **Avoiding Exploitation:** Public utilities are the necessities of life. If the private individuals are allowed to trade in these products, the common man gets exploited.

➢ **Problems of Public Enterprises:**

- **Political Interference:** Political parties try to influence the functioning of public enterprises, which may affect the efficiency of the enterprises.
- **Accountability:** Lack of accountability becomes a hindrance to these enterprises.
- **Delay in Completion:** Due to the lack of attention paid, it may take long time to complete the projects. This may increase the cost of the project.
- **Over Staffing:** These enterprises, due to political interference, may hire or recruit employees, much more than the required number.
- **Less Return:** The rate of return on capital is low due to inefficient management, political interference etc.

➢ **Types of Public Sector Enterprises:** Public enterprises can be classified into three categories:



I. DEPARTMENTAL ORGANISATION:

This is the earliest form of public enterprise. Under this form, each department has a minister, who controls the operations of these enterprises. Normally a managing director is appointed to control these enterprises. IAS offices are posted as the managing directors. Ex: Railway Department.

➢ **Features :**

1. These departmental organizations are controlled and managed by the government through IAS officers.
2. The capital or finance is provided from the government revenue.
3. The budgets of these undertakings are approved and passed by the legislature.

➢ **Advantages:**

1. **Efficiency:** These undertakings can work efficiently because they are controlled by the minister of the department.
2. **Accountability:** Accountability becomes possible because the budget of the undertaking is passed by the legislature.
3. **Source of Finance:** It is a direct source of revenue for the government.

➢ **Disadvantages:**

1. **Reactive Decisions:** The decisions taken by these undertakings, with regard to market changes, are reactive. They do not normally, take a pro-active approach.
2. **Excessive Government Control:** Government does not allow adequate freedom to these undertakings, which hider's their growth.
3. **Inefficient Staff:** These undertakings lack competent staff, which may be because of the recruitment policy, monetary benefits offered to the employees etc.
4. **Slow response to market conditions**: Since there is no competition, there is no profit motive; there is no incentive to move quickly to market needs.

SOLE-PROPRIETORSHIP

Q2. What is Sole Proprietorship? What are the features, advantages and disadvantages, explain.

Ans:

Definition:

"A sole proprietorship is a form of private sector enterprise that is owned, managed and controlled by an individual entrepreneur". Such individual entrepreneur is called as sole-proprietor. The sole proprietor arranges the finance, manages the business affairs, takes the profits or bears the losses.

➢ **Features of Sole Proprietorship:**

1. **Individual ownership:** Solo-Proprietorship form of organization is owned by an individual.
2. **Individual Management and Control:** It is managed and controlled by the sole proprietor.
3. **Individual Financing:** Such organization is financed by an individual person.
4. **Unlimited Liability:** The liability of sole proprietor is unlimited. If the business assets are not sufficient to meet the business liabilities, his private assets are to be used to discharge the business liabilities.
5. **Minimum Government Regulations:** There are minimum government regulations to set up such form of organization. Ex: we can start a fruit stall without much legal formalities.

➢ **Advantages of Sole Proprietorship:**

1. **Easy to Start and Easy to Close:** Formation of sole proprietorship is very easy. Even closing the business is also easy.
2. **Personal Touch with Customer:** It is possible for the sole-proprietorship to have personal contact with the customer and understand his tastes and preferences and maintain required stock.
3. **Quick Decisions:** Sole proprietor is the owner of the business. So there is no need to consult any other person before taking any decision regarding his business. Therefore, quick decisions can be taken by him.
4. **Business Secrecy:** Full secrecy can be maintained since business secrets are known to proprietor only.
5. **Total Control:** The ownership, management and control are in the hands of the sole proprietor and hence it is easy to maintain the hold on business.
6. **Sole Beneficiary of Profits:** All the profits of the business belong to the sole-proprietor. This motivates the proprietor to work hard and develop the business to get more profits.
7. **Suitable for Small Scale Operations:** The sole proprietorship is very suitable for small scale operations.

➢ **Disadvantages or Limitations of Sole Proprietorship:**

1. **Unlimited Liability:** The sole proprietor has an unlimited liability. If the business assets are not sufficient to meet the business liabilities, his private assets are to be used to discharge the business liabilities.
2. **Limited Financial Resources:** The sole proprietor has a limited capital and has limited capacity to raise funds because of limited personal assets. This limitation reduces the scope for expansion and growth of business.
3. **No Division of Labour:** Sole proprietor being the only person handling the business, will not enjoy the benefits of dividing the work among specialized labours. Anyhow, a sole proprietor can appoint people to help him, but the number of such people could be less taking into account.
4. **Uncertainty:** A sole trade business will exist only till the existence of the sole trader. In case of his death, insanity, the business may come to an end.
5. **More Competition:** Because it is easy to start small business, there is a high degree of competition among the small business men.

Q7. Define the Joint Stock Company & Explain Features, Advantages and Disadvantages.

Ans: The drawbacks of sole-proprietorship and partnership gave rise to company form of organization. The first joint stock company was started in Italy in 13th Century. In India the first companies Act was passed in 1850. In 1956, a comprehensive act was passed, which is still in existence.

Definition:

"A joint stock company is a voluntary association of persons for profits whose capital is divided into transferable shares and ownership is required for its membership"

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[redacted]

➢ **Features of Joint Stock Company:**

1. **Artificial Person:** A company is an artificial person created by law. It has its own name and seal. It can perform all the activities of business like purchase and sale of goods etc.

2. **Voluntary association of persons:** It is a voluntary association of persons who want to carry on business for profit. To carry on business, they need capital. So they invest in the share capital of the company.

3. **Capital is divided into shares:** In this form of business total capital is divided into a certain number of units. Each unit is called a share.

4. **Common Seal:** It is an artificial person created by law has no physical shape, it can not sign its name on a paper. So, it has a common seal on which its name is engraved.

5. **Management and Ownership in separate hands:** Shareholders are the owners of the business. But they do not manage the business. The board of directors appointed by them to manage the company.

6. **The name of the company ends with „limited":** It is necessary that the name of the company ends with limited (Ltd.) to give an indication to the outsiders that they are dealing with the company with limited liabilities.

➢ **Advantages of Joint Stock Company:**

1. **Limited Liability:** The shareholders have limited liability i.e., liability limited to the face value of the shares held by him.
2. **Transferability of shares:** When in need of money, a shareholder can transfer his share in the company to any persons by following the procedure laid down for such a transfer.
3. **Availability of Large resources:** As the capital is collected from the public, by selling the shares in the primary market, a company enjoys the benefit of large resources.
4. **Stability of Existence:** The company has perpetual existence. Its existence is not affected by death, insolvency of any of its members.
5. **Efficient Management:** The affairs of the company can be managed efficiently since the company is in a position to employ experts as professional managers due to availability of large amount of funds.
6. **Economies of Large Scale Production:** With the availability of huge capital and management expertise, a joint stock company enjoys economies of marketing, production, specialization, etc.

➢ **Disadvantages of Joint Stock Company:**

1. **Difficulty in Formation:** In order to start a company many legal formalities are to be fulfilled. These formalities can be very expensive.

2. **Delay in Decision Making:** In a company form of organization decision making will be very lengthy. No single individual can take any decision. Only the board of the director's can take decisions, which can be ratified by the shareholders in the annual meeting.

3. **Lack of Secrecy:** When compared to other form of business, a company form of organization may not be able to maintain secrecy. Every matter has to be informed to the shareholders, which may not remain secret thereafter.

4. **Separate Ownership and Management:** The management and the owners of the company are not directly related. Management unlike sole proprietorship and partnership may not take personal interest in the growth of the company.

Types of Joint Stock Company

The joint stock company is divided into three different types.

- **Chartered Company** – A firm incorporated by the king or the head of the state is known as a chartered company.
- **Statutory Company** – A company which is formed by a particular act of parliament is known as a statutory company. Here, all the power, object, right, and responsibility are all defined by the act.
- **Registered Company** – An organisation that is formed by registering under the law of the company comes under a registered company.

DOUBLE ENTRY SYSTEM

10 **Introduction and Meaning:**

Double entry system was introduced in 1494 by an Italian merchant „Luca Pacioli". According to double entry system, every business transaction has two aspects. One aspect is receiving and the other aspect is giving. The receiving aspect is termed as "debit" and the giving aspect is termed as "credit".

When we receive something, we give something else in return also. For example, when we sell goods for cash, we receive cash and give goods in return. Thus, on any date, the total of all debits must be equal to the total of all credits, because every debit has a corresponding credit. This is known as the fundamental principle of double entry system.

➢ **Advantages of Double Entry System:** The following are the advantages of double entry system:

1. **Complete and Scientific Record:** The main advantage of the double entry system is that it helps to maintain a complete and scientific record of business transactions as both the aspects of each and every transaction are recorded in it.

2. **Full Information:** Full and authentic information can be had about all transactions as the trader maintains the ledger with all types of accounts.

3. **Assessment of Profit or Loss:** The businessman will be able to know correctly whether he had earned profit or sustained loss.

4. **Assessment of Financial Position:** The businessman will be able to know fully about the financial position of the firm by prepare the balance sheet.

5. **Helpful in Comparison:** This system is helpful in making comparison of current year business result those of previous years.

6. **Helpful in preventing Errors and Frauds:** The systematic and scientific recording of business transactions on the basis of this system minimizes the chances of errors and frauds. These can be easily detected by vouching, verification and auditing of accounts.

7. **To Meet Legal Requirements:** Proper maintenance of books will satisfy the tax authorities and facilitates accurate assessment. In India joint stock companies should maintain accounts under double entry system.

11 Appraising a project in managerial economics and finance involves evaluating its feasibility,
profitability, and potential risks. Modern techniques for project appraisal integrate both quantitative
12 and qualitative tools to ensure comprehensive analysis. These techniques help managers make
informed decisions regarding investment projects. The key modern techniques used for appraising
projects are:

1. Net Present Value (NPV)

- **Concept:** NPV is a method that calculates the present value of the expected future cash flows of a project, discounted at the project's cost of capital. It compares the investment cost to the discounted cash flows to determine profitability.
- **Formula:**

$$NPV = \sum \frac{C_t}{(1+r)^t} - C_0$$

  Where:

  - C_t = Cash inflow during the period
  - r = Discount rate
  - t = Time period
  - C_0 = Initial investment

- **Decision Rule:** If NPV > 0, the project is considered profitable; if NPV < 0, the project should be rejected.

2. Internal Rate of Return (IRR)

- **Concept:** IRR is the discount rate that makes the NPV of a project equal to zero. It represents the expected rate of return of the project.
- **Calculation:** IRR is calculated iteratively or using financial software, where the NPV is set to zero, and the discount rate (IRR) is found.
- **Decision Rule:** If IRR > the required rate of return or the cost of capital, the project is considered acceptable.

3. Payback Period

- **Concept**: The payback period is the time required for the project's cash flows to repay the initial investment.
- **Formula**:

$$Payback\ Period = \frac{Initial\ Investment}{Annual\ Cash\ Inflow}$$

- **Decision Rule**: Projects with a shorter payback period are preferred because they reduce risk and recover the investment faster. However, this method does not consider the time value of money.

4. Profitability Index (PI)

- **Concept**: PI is the ratio of the present value of future cash flows to the initial investment. It is used to rank projects when available resources are limited.
- **Formula**:

$$PI = \frac{\text{Present Value of Future Cash Flows}}{\text{Initial Investment}}$$

- **Decision Rule**: If PI > 1, the project is considered profitable.

5. Cost-Benefit Analysis (CBA)

- **Concept**: CBA involves comparing the costs and benefits of a project. All costs and benefits, including tangible and intangible factors, are converted into monetary terms.
- **Decision Rule**: A project is acceptable if the total benefits outweigh the total costs (i.e., Benefit-Cost Ratio > 1).

6. Sensitivity Analysis

- **Concept**: This method examines how sensitive a project's outcome (e.g., NPV) is to changes in key assumptions or variables like sales volume, costs, and discount rates. It tests how risks in input factors could affect the project's overall viability.
- **Decision Rule**: Projects with lower sensitivity to fluctuations in variables are generally preferred.

7. Scenario Analysis

- **Concept**: Scenario analysis involves creating different scenarios (e.g., best-case, worst-case, and most-likely-case) to evaluate the project's outcomes under various assumptions. It is used to assess the risks and potential variability in a project's results.
- **Decision Rule**: Projects with favorable outcomes across different scenarios are considered better investments.

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8. Monte Carlo Simulation

- **Concept**: This technique uses random sampling and statistical modeling to simulate various possible outcomes of a project based on different risk factors. It generates a range of possible outcomes (probability distribution) rather than a single point estimate.
- **Decision Rule**: Projects with a higher probability of positive NPV or favorable outcomes are selected.

9. Real Options Analysis

- **Concept**: Real options recognize that managers have the flexibility to adapt their strategies as uncertainties resolve. It evaluates the value of having options such as delaying, expanding, or abandoning a project.
- **Example**: A company might delay launching a new product to gather more market data, giving them the "option" to invest later if conditions improve.
- **Decision Rule**: Projects with valuable real options increase their attractiveness as they reduce risk and offer future opportunities.

10. Economic Value Added (EVA)

- **Concept**: EVA measures a project's performance based on residual income, which is the income generated after deducting the cost of capital. It evaluates whether the project adds value to shareholders.
- **Formula**:

$$EVA = NOPAT - (Capital \times Cost\ of\ Capital)$$

  Where:

  - NOPAT = Net Operating Profit After Taxes
  - Capital = Investment made in the project
  - Cost of Capital = Weighted Average Cost of Capital (WACC)
- **Decision Rule**: A project with positive EVA creates shareholder value.

11. Risk-Adjusted Discount Rate (RADR)

- **Concept**: RADR incorporates risk into the discount rate used to calculate NPV. Projects with higher risks are discounted at a higher rate, reducing their present value.
- **Decision Rule**: Projects with a higher risk-adjusted NPV are preferred over those with lower risk-adjusted values.

12. Adjusted Present Value (APV)

- **Concept**: APV separates the effects of financing decisions from the core project evaluation by first calculating the NPV of the project without debt and then adding the benefits of debt (e.g., tax shields).
- **Formula**:

$$APV = NPV\ (unleveraged) + NPV\ (financing\ benefits)$$

- **Decision Rule**: Projects with higher APV are more attractive, especially when considering financing structures.

13. Break-Even Analysis

- **Concept**: This method calculates the point at which the project's revenues will cover all its costs, both fixed and variable.
- **Formula**:

$$Break - Even\ Point = \frac{\text{Fixed Costs}}{\text{Sales Price per Unit} - \text{Variable Cost per Unit}}$$

- **Decision Rule**: Projects with a lower break-even point are less risky and more financially viable.