

## UNIT - I

### Learning Objectives:

After reading this chapter you will be conversant with:

- Meaning and Definitions of Financial services
- Kinds of Financial services
- Evolution and growth of these services
- Nature and characteristics of financial services
- Goods marketing v/s service marketing
- Strategic financial services
- Services Marketing triangle

The Financial services sector in India is blooming and has become one of the lucrative areas to professionalism. The sector has undergone metamorphosis since 1990. Indian economy got liberalized during 1991 and the financial sector was kept open for private and foreign players. During the late eighties, the financial services industry in India was dominated by commercial banks and other financial institutions governed by the Central Government. The economic liberalization has brought in a complete transformation in the Indian financial services industry.

Prior to the economic liberalization, the Indian financial service sector was characterized by various other factors, which was related to the growth of this sector. Some of the factors of significance are as follows:

- ❑ Too much of control and regulation by the apex bodies in the form of interest rates, money rates etc.
- ❑ Controller of capital issues used to regulate the prices of securities
- ❑ Absence off independent credit rating and credit research agencies.
- ❑ Strict regulation of the foreign exchange market
- ❑ Restrictions on foreign investment and foreign equity

- Non-availability of debt instruments on a large scale.

However, after the economic liberalization the entire financial sector has undergone a sea-saw change and now new financial instruments are entering the capital market on a daily basis. The present scenario in the Indian Capital market is characterized by financial innovation and financial creativity.

Financial services basically mean all those kinds of services provided in financial or monetary terms, where the essential commodity is money. These services include; Leasing, Hire purchase, venture capital, Merchant banking, Insurance, housing finance, Mutual funds, factoring, stock broking and many others.

### **MEANING OF FINANCIAL SERVICES**

The term Financial services in its broader sense refers to “mobilizing and allocation of savings”. It is identified as all those activities involved in the process of converting savings into investment. Financial services also include FINANCIAL INTERMEDIARIES such as Merchant Bankers, Venture capitalists, Commercial banks, Insurance Companies etc.

### **CLASSIFICATION OF FINANCIAL SERVICES INDUSTRY**

The financial services industry can be conventionally classified into two categories:

- i) Capital market intermediaries, consisting of term lending institutions and investing institutions providing long-term funds.
- ii) Money market intermediaries, include commercial banks, co-operative banks and other agencies, which supply funds for short-term requirements. Therefore, the term financial services include all kinds of organizations, which intermediate and facilitate financial transactions of both individuals and corporate customers.

The entities that provide these services are divided into the following categories:

- Non-Banking Finance companies (NBFCs)

- Commercial banks and
- Investment bank

### **EVOLUTION OF FINANCIAL SERVICES IN INDIA:**

Financial services sector is blooming in India and it has passed through various phases as mentioned below:

- i) Initial phase (1960-80)
- ii) Second phase (1980-90)
- iii) Third phase (1990-2002)

i) **Initial phase:**

Financial services at the initial phase introduced many innovative services such as merchant banking, Insurance and leasing finance. The term merchant banking was not known till 1960. It was used as an umbrella function. Its activities start from project appraisal to mobilization of finance from suppliers. They also underwrote the public issues and helped in getting the shares listed in the stock exchange. LIC, GIC and UTI initiated to enter into this segment during this period. Leasing activities was started in the year 1970. Initially leasing companies were engaged in equipment lease financing. Afterwards they have undertaken different kinds of leasing such as financial lease, operating lease and wet leasing.

ii) **Second phase:**

Financial services entered the second stage and it covered the period of 10 years approximately. In this phase it introduced many innovative value added services such as over the counter share transfers, pledging of shares, mutual funds, factoring, discounting, venture capital and credit rating. Mutual funds provide major fund to the industry anywhere in the developed countries. Credit rating reduces malpractices in the capital market and this rating is applied

only to debt instruments only. Now this rating is mandatory for commercial papers and fixed deposits.

iii) **Third phase:**

This phase in financial services include the setting up of new institutions and instruments. This period started after post liberalization. The depositories, the stock lending schemes, online trading, paperless trading, dematerialization, book buildings are the contemporary issues of this phase. This phase has initiated to popularize book building to help both investors and fund mobilizes. In this phase government has taken initiatives to allow foreign institutional investors into the capital market. The government of India is revamping companies' act, income tax act, MRTP act etc, for delivering effective financial services.

**PRESENT SCENARIO:**

i) **Conservatism to dynamism:**

At present, the financial system in India is in a process of rapid transformation, after the liberalization of financial sector. The main objective of the financial sector reforms is to promote an efficient, competitive and diversified financial system in the country. Now the Indian financial services sector is very dynamic and it is adopting itself to the changing needs.

ii) **Emergence of Primary Equity Market:**

Primary market in India is now very active. India is now witnessing the emergence of many private sector financial services. Capital market is one of the major places to raise finance. The aggregate funds raised in the Indian capital market have doubled over a decade.

iii) **Concept of Credit Rating:**

The facility of credit rating helps the investors in finding a profitable and safe debt capital. It rates the debt issues and instructs the investors not to invest in the debt capital of the firms that are badly rated. The regulators of the Indian capital market are contemplating on introducing Equity grading, which helps the investors to prudently invest their savings.

iv) **Process of Globalization:**

Globalization has given way for the entry of innovative and sophisticated financial products into our country. Government of India is very keen in removing all the obstacles in the financial sector. Indian capital market has high potential for the introduction of innovative financial products.

v) **Process of liberalization:**

Government of India has initiated many steps to reform the financial services industry. The interest rates have been deregulated. The private sector has been permitted to participate in banking and mutual fund sectors. The Finance Act of Government of India is bringing various amendments every year to keep the financial sector very flexible.

**FUNCTIONS OF FINANCIAL SERVICE INSTITUTIONS:**

- A) These firms not only help to raise the required funds but also assure the efficient deployment of funds.
- B) They assist in deciding the financing mix
- C) They extend their service up to the stage of servicing of lenders.
- D) They provide services like bill discounting, factoring of debtors, parking of short-term funds in the money market, e-commerce, securitization of debts, and so on to ensure an efficient management of funds.
- E) These firms provide some specialized services like credit rating, venture capital, lease financing, factoring, mutual funds, merchant banking, stock

lending, depository, credit cards, housing finance, and so on. These services are generally provided by banking companies, insurance companies, stock exchanges and non-banking companies.

### **CONSTITUENTS OF FINANCIAL SERVICES:**

The financial services comprise of the following major constituents in the financial system. They are:

- a) Financial instruments
- b) Market players
- c) Specialized Institutions
- d) Regulatory bodies

#### **a) Financial Instruments:**

It includes equity, debt and hybrid. These instruments are written evidences of ownership and they give the holders the right to demand and receive property not in their possession.

The ownership of a corporation is divided into various units and each unit is called as a share. A shareholders interest is evidenced by a stock certificate, which states the name of the shareholder, the class of stock and the number of shares owned.

Debenture is a certificate issued by the company under its common seal acknowledging the debt to be repayable with interest.

Hybrid instrument is the combination of both equity and debt instruments.

#### **b) Market players:**

The players in the market include:

- i. Commercial banks
- ii. Financing companies
- iii. Stock brokers
- iv. Consultants

v. Underwriters

vi. Market makers

**i. Commercial Banks:**

The commercial banking in the developed countries provide term loans to corporate sector by participating in the capital and equipment finance. The commercial banking has undergone a number of structural and functional changes in the developing countries. The Indian banks have recently commenced hire purchasing finance, leasing, factoring and other services.

**ii. Financing companies:**

The participation of finance organizations can stimulate the economic growth. They inject new blood to the corporate sector. All these reflections made for the evolution of a vibrant, competitive and dynamic financial system, the Non-Banking Finance Corporations sector has recorded marked growth in the recent past.

**iii. Stock Brokers:**

Stock Brokers play an important role in the stock market. They involve in buying and selling of securities in a recognized stock exchange. If any one wants to work as a broker, a certificate of registration from the SEBI is mandatory after satisfying all the terms and conditions. SEBI will grant the registration to the brokers. The membership in the stock exchange can be granted as individual membership and corporate membership.

**iv. Consultants:**

Consultants are the professionals in the area of Finance can be providing best solutions to the problems faced by the corporate sector. They are pioneer in their field and render the quality service with high integrity and standards. A financial consultant occupy a key role in problem solving solution like in all areas of functional management such as production, finance, marketing and human resources. Their services are intangible and show greater impact on the

functioning of the company. They provide tailor made solution to all the problems irrespective of any area.

**v. Underwriters:**

Underwriters are the intermediaries in the primary market. They provide assurance to the companies, which approach the capital market for raising the financial resources. They render valuable services to the newly started companies, which require believable advice. Underwriters assure the company full subscriptions for a commission.

**vi. Market makers:**

Market makers are associated with the stock exchanges. The market making system is very much popular in London, New York and Chicago stock exchanges. Their basic function is to provide the needed liquidity to a particular scrip. They help in eliminating the temporary disparity between the supply and demand of scrip. They help in maintaining a fair and orderly market.

**c) Specialized Institutions:**

Financial services area meant for providing solution to various problems faced by the corporate sector. The provider of financial services remains in constant touch with the dynamic market. The financial markets are required to develop specialized institutions to solve the financial problems of the corporate sector. These specialized institutions include acceptance houses, Discount houses, Factors, Depositories, Credit rating agencies, Venture capital. These institutions provide solutions to the financial problems of the corporate sector.

**d) Regulatory Bodies:**

Regulations are the most important factor in any area of financial system. The Financial markets are highly volatile and need a close observation by the Government. The government of India watches the market affairs on daily basis through its nominee SEBI. The government regulates the financial system through various legal organs of the administration. The banking affairs are



monitored by the RBI. The corporate affairs are regulated by the company law board and board for industrial and financial reconstruction.

### **CLASSIFICATION OF FINANCIAL SERVICES INDUSTRY:**

The financial intermediaries in India can be traditionally classified into two parts:

- i) Capital market intermediaries and
- ii) Money market intermediaries.

The capital market intermediaries consist of term lending institutions and investing institutions, which mainly provide long-term funds.

On the other hand, money market consists of commercial banks, co-operative banks and other agencies, which supply short-term funds. Hence the term financial services industries include all kinds of organizations, which intermediate and facilitate financial transactions of both individual and corporate customers.

### **KINDS OF FINANCIAL SERVICES:**

- **LEASING:**

The term leasing refers to a contract under which the owner of an asset allows another person or party to use the asset in return for some rent. The persons involved are lessor and lessee. Lessor is the owner of the asset and the lessee is the person getting the benefit of asset taken on lease.

Steps involved in Leasing:

A contract of lease provides a person an opportunity to use an asset, which belongs to another person. The following steps are involved in a leasing transaction:

- a) At the first instance the lessee has to take a decision regarding the required asset. Then he has to select a supplier before selecting the type of machine.

- b) The lessee then enters into a lease agreement with lessor. The lease agreement contains the terms and conditions of the lease such as, lease period, rental payments, details regarding renewal of lease period, cost of repair and maintenance, insurance and any other expenses.
- c) After the lease agreement is signed the lessor consents the manufacturer and requests him to supply the asset to lessee.

**Types of leasing:**

- **Financial lease:** It is also known as Capital lease or Long-term lease. It is like a legal commitment to pay for the entire cost of the equipment plus interest over a specified period of time. The lessee agrees to a series of payment which in total exceeds the cost of equipment.
- **Operating lease:** It is a rental agreement. The lessee is not committed for paying more than the original cost of equipment during contractual period. Lessor will bear the maintenance expenses and taxes of the lessor.
- **Sale and lease back:** Under this type of lease, a firm, which has an asset, sells it to the leasing company and gets it back on lease. The asset is generally sold at its market value. The firms receive the sale price in cash and get the right to use the asset during the lease period. The firm makes periodical rental payment to the lessor. The ownership of asset rests with lessor.
- **Cross border lease:** This is also known as international leasing or transnational leasing. This is referred to a lease transaction between the persons of two countries. The lessor and the lessee belong to two different countries.

- **MERCHANT BANKING:**

Merchant banks are financial institutions providing specialist services that generally include the acceptance of bills of exchange, corporate finance, portfolio management and other banking services.

**Services of merchant banks:**

A merchant banker helps in the process of issue management and his services are broadly categorized as pre-issue management and post issue management.

The pre-issue management involves the following:

- Printing prospectus
- Pricing of issues
- Marketing the issue
- Underwriting
- Listing of securities in stock exchange

Post issue management includes the following:

- Collection of application forms
- Screening the applications
- Deciding allotment procedure
- Mailing of letter of allotment
- Issue of share certificates
- Refund of application money to non-allottees.

A merchant banker acts as a liaisoning officer at the event of mergers and acquisitions. He helps the company in managing its portfolio.

A merchant banker help their clients in off shore financing such as long term foreign currency loans, joint ventures abroad, licensing and franchising, financing exports and imports, foreign collaboration arrangements etc.

The services of Merchant bankers also include investment advisory to Non-Resident Indians in terms of identification of investment opportunities, selection of securities, investment management etc. They also take care of the operational

details like purchase and sale of securities, securing necessary clearance from RBI.

- **MUTUAL FUND:**

A mutual fund is a corporation, trust or partnership that combines the assets of all its shareholders or partners into one common investment account for the purpose of providing diversification and professional management. 'A mutual fund means pooling the investments of a number of investors by way of investment in units of equal size'. The concept of Mutual funds was started with unit schemes of Unit Trust of India in 1964 in India. The term mutual funds came into prominence only in 1987 when leading public sector banks like SBI, Canara bank set up their mutual funds, followed by LIC of India in 1989. From the year 1993 the mutual funds were allowed to start under private sector also. At present in India there are 40 mutual fund companies in India.

**ORGANISATION OF MUTUAL FUND COMPANIES IN INDIA:**

The organization of mutual funds involves five constituents or special bodies.

They are:

- a) The sponsor/s
- b) The board or trustees
- c) The asset management company (AMC)
- d) The custodian and
- e) The unit holders.

A mutual fund is set up in the form of a trust, which has sponsor, trustees, Asset Management Company and custodian. The trust is established by a sponsor or more than one sponsor who is like a promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. AMC approved by SEBI manages the fund by making investments in various types of securities. Custodian who is registered with SEBI holds the securities of various schemes

of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI regulations by the mutual fund.

#### **CLASSIFICATION OF MUTUAL FUNDS:**

- A Mutual fund scheme can be classified into open-ended or closed ended schemes depending on its maturity period.
- An open-ended scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period.
- A closed ended scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed.
- The schemes can also be classified as Growth funds, income funds and balanced funds.

- **Growth funds:**

The growth funds aim to provide capital appreciation over the medium to long term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend; capital appreciation etc. and the investors can choose an option depending on their preferences.

- **Income funds:**

These funds aim to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, government

securities and money market instruments. These funds are not affected by the market fluctuations.

- **Balanced funds:**

These funds provide both growth and regular income as such schemes invest both in equities and fixed income securities. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments. These funds are also affected by fluctuations in share prices in the stock market.

- The other schemes are as follows: Money market mutual funds, Indexed funds, Sector schemes, Tax saving schemes, load funds, no load funds etc.

- **Money market mutual funds:**

These are income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short term instruments such as treasury bills, certificates of deposit, commercial paper and inter bank call money, government securities etc.

- **Indexed funds:**

These funds invest exclusively in the government securities. Government securities have no default risk. Net asset values of these schemes also fluctuate due to change in interest rates and other economic factors as in the case of income or debt oriented schemes.

- **Sector schemes:**

These are the funds, which invest in the securities of only those sectors or industries as specified in the offer documents. Eg. Software industries, pharmaceuticals, FMCGS etc. The returns in these funds are dependent on the performance of the respective

sector. While these funds may give higher returns, they are more risky as compared to diversified funds. Investors need to keep a watch on the performance of these sectors and must exit at an appropriate time besides seeking expert advice.

- Tax saving schemes:

These schemes offer tax rebates to the investors under specific provisions of the income tax act of 1961, as the government offers tax incentives for investment in specified avenues. EG. Equity linked saving schemes, pension schemes etc.

- Load fund:

A load fund is one that charges a percentage of Net asset value for entry or exit. Each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distributing expenses.

- No-load fund:

This fund is one that does not charge for entry or exit. It means the investors can enter the fund at Net asset value and no additional charges are payable on purchase or sale of units. The price a unit holder is charged while investing in an open-ended scheme is called sales price.

### **FUNCTIONS OF MUTUAL FUNDS:**

- ❖ The basic function of mutual fund companies is buying and selling securities on behalf of its unit holders,
- ❖ It enables small investors to hold a share in a large and diversified portfolio of assets, which reduces the risks of investment.
- ❖ The savings so mobilized are pooled in a large, diversified and sound portfolio of equity, bonds, securities etc.
- ❖ Investors in the mutual funds are given the share in its total funds, which is evidenced by the unit certificates.

- ❖ Mutual funds assure professional management, which helps in earning higher rate of return.
- ❖ It helps the small investors who do not have adequate time and knowledge, expertise, experience and resources for directly accessing profitable avenues in capital and money markets.

### **NET ASSET VALUE:**

The repurchase price is always linked to the Net Asset Value. The NAV is nothing but the market price of each unit of particular scheme in relation to all assets of the scheme. It can also be called as intrinsic value of each unit. This value is a true indicator of the performance of the fund. If the NAV is more than the face value of the unit, it clearly indicates that the money invested on that unit has appreciated and the fund has performed better.

- **CREDIT RATING:**

Credit rating is an assessment, by an independent agency of the capacity of an issuer of debt security to service the debt and repay the principal as per the terms of issue of debt. A rating agency collects the qualitative as well as the quantitative data from a company, which has to be rated, and assesses the relative strengths and capability of company to honour its obligations contained in the debt instrument throughout the duration of the debt instrument. The rating given is based on an objective judgment of a team of experts from the rating agency involved in credit rating.

### **OBJECTIVES OF CREDIT RATING:**

- It imposes a financial discipline on the borrowers
- It helps the financial intermediary in discharging the functions relating to the debt issues.
- It guides the investor regarding the commitment towards a particular debt instrument for better returns.



- It facilitates the formulation of the public guidelines on the institutional investment.
- It may provide adequate funds for the high rated companies at a low rate of interest.
- It lends greater credibility to the financial and other representatives.
- It encourages transparency of information and better accounting standards.

#### **CREDIT RATING PROCESS:**

- A) The issuing company approaches the rating agencies.
- B) On the basis of client needs, rating agency appoints a team of experts to appraise the financial position of the company.
- C) The experts team makes report to the agency appoints a team of experts to appraise the financial positions.
- D) Credit rating agency submits, its observations about the quality of debt instrument through symbols.

#### **CREDIT RATING AGENCIES IN INDIA:**

- i) Credit Rating and Information services of India (CRISIL)
- ii) Investment Information and Credit Rating Agency of India Limited (ICRA)
- iii) Credit Analysis and Research Limited (CARE)
- iv) Onida Individual Credit Rating Agency of India Limited. (ONICRA)

#### **CRISIL**

CRISIL was established in January 1988. It was floated by ICICI, UTI, LIC, GIC and Asian development bank. Its objective is to undertake the assignments of the credit rating based on the proposal made by the issuer companies for their financial products. They are debentures, fixed deposit programmes, commercial papers, short term borrowing instruments and preference shares. CRISIL rating is necessary for the authorities and banks. The CRISIL provides not only the credit rating but also renders services to the corporate sector covering the topics like structure of the industry, degree of competition and business situations.

### **ICRA**

ICRA was promoted by the Industrial Corporation of India. It has come into existence in August 1991. It has headquarters at Delhi. It was an independent company limited by shares with an authorized share capital of Rs.10crores. The main objective is to assess the credit instruments and assign a grade constant to the risk associated with such instrument. The rating is based on an objective analysis of the information provided by the client company. It helps the investors in making well-informed investing decisions. It assists the issuer company in raising funds from wider investors.

### **CARE**

CARE is the third credit rating agency in India. These ratings are accepted by the SEBI, the RBI and the Government of India. The IDBI and other institutions promote it. The regulatory authorities have made rating a necessary grading for entering into the market. It is incorporated as a public limited company under the Indian companies Act. CARE is run by Board of Directors. It consists of eminent persons with a varied experience in financial services and allied areas. The company is an autonomous body and enjoys full freedom in its operations and ratings are also accepted by the market.

### **VENTURE CAPITAL:**

It is a form of financing, designed for funding high technology, high risk and perceived high reward projects. A venture capitalist provides funds to entrepreneurs and enterprises pursuing in the new and unexplored avenues. Venture capitalist helps the promoter to actualize the project and attain commercialization.

**Features of venture capital:**

- i. Venture capital is usually will be in the form of equity participation.
  - ii. The investment is made only in high tech projects having high growth potential.
  - iii. Venture capitalist joins the firm as a co-partner and shares the risk and reward of the enterprise.
  - iv. Once the started venture reaches the full potential and starts earning profit, the venture capitalist will withdraw his investments.
  - v. This type of investment is generally made in small and medium scale business houses.
  - vi. Venture capital is available only for commercialization of new ideas and it is not available for the firms engaged in trading, financial services, research and development etc.,
- **FACTORING:** It may be defined as a continuing arrangement between the financial institutions or banks and a business concern selling goods or providing services on credit, wherein the factor undertakes the task of recording, collecting, controlling and protecting the book debts and also purchasing the bills receivables of the suppliers.

**Factoring involves the following functions:**

- a) Purchase and collection of debts
- b) Management of sales ledger
- c) Credit investigation

- d) Provision of finance against debt
- e) Rendering consultancy services

### **LOAN SYNDICATION:**

This is also referred as consortium financing. This work is taken up by the Merchant banker and he arranges loans to the customers by accumulating money from various sources. If a single bank cannot provide a huge sum of loan, a number of banks join together and form a syndicate. It enables the members of the syndicate to share the credit risk associated with a particular loan among themselves.

### **SCOPE OF FINANCIAL SERVICES:**

Financial services cover a wide range of activities. They can be broadly categorized into two parts namely:

- (a) Traditional activities
- (b) Modern activities

### **TRADITIONAL ACTIVITIES:**

Conventionally the financial services are identified under two heads:

- (i) Fund based activities and
- (ii) Non-fund based activities

The traditional services which come under fund based activities are the following:

- Underwriting of shares, debentures etc
- Dealing in foreign exchange market activities
- Equipment leasing, hire purchase, venture capital etc.
- Dealing in secondary market activities
- Participating in money market instruments like treasury bills, discounting bills, commercial papers etc.

Non-fund based activities include:

- The management of capital issues (pre and post issue management)
- Arrangement for the placement of capital and debt instruments with investment institutions
- Arrangement of funds from financial institutions
- Placement of capital and debt instruments with investment institutions
- Arrangement of working capital for his clients
- Assisting in the process of obtaining government Clearance.

#### **MODERN ACTIVITIES:**

It includes

- Rendering project advisory services, right from the preparation of the project report till the raising of funds for starting the project
- Planning for mergers and acquisitions and assisting for their smooth carry out.
- Directing corporate customers in capital restructuring
- Acting as trustees to the debenture holders
- Recommending suitable changes in the management structure and management style envisaging to achieve better results.
- Portfolio management of large public sector undertakings
- Capital market services such as, Clearing services, Registration and transfers, collection of income on securities etc,

#### **NATURE AND CHARACTERSTICS OF FINANCIAL SERVICES:**

- Financial services involve at least two people or firms, the service provider and the user.

- Financial institutions intermediate the flow of funds between different economic decision-making units.
- The financial services are intangible. It smoothens the functioning of the corporate sector by providing funds within the stipulated period of time.
- Financial services must be customer friendly and they should provide the services according to the requirements of the customers.
- Financial service is an innovative activity and requires dynamism. It has to be consistently redefined and refined on the basis of economic changes.

#### **FINANCIAL SERVICES MARKETING v/s GOODS MARKETING:**

(Goods and services merge, but on the conditions of services)

Financial service is one of the important elements in Indian financial system. It fulfils the needs of financial institutions, intermediaries and investors. Financial markets bring together financial institutions, intermediaries and investors.

The basic differences between goods and services marketing are given below:

#### **OWNERSHIP:**

In case of goods marketing the customers get the ownership of the goods sold. Where as in case of services marketing the customers derive value from services without obtaining ownership of any tangible elements.

#### **INVENTORY:**

The goods manufactured can be inventoried and can be sold as per the demand requirements. Since, service is a deed or performance it cannot be inventoried. However, facilities, equipment and labour can be held in readiness to create service.

#### **TANGIBILITY:**

Goods are tangible in nature and the services are intangible. Goods are tangible dominant and the services are intangible dominant.

**DISTRIBUTION CHANNELS:**

Manufacturers require physical distribution channels to move goods from factory to customers. Service business houses choose to combine the service factory, retail outlet and point of consumption at a single location or use electronic means to distribute their services.

**TIME FACTOR:**

Service marketers need to understand customers' time constraints and priorities; a marketer has to minimize waiting time. A goods' marketer should also be time conscious. He should try to reduce the lead-time i.e., the time between the place of order and delivery.

**EVALUATION:**

Physical goods' customers evaluate the products prior to purchase in terms of color, shape, price, fit and feel whereas service customers emphasize on experience properties such as taste, ease of handling, personnel treatment, etc.

**VARIABILITY IN OPERATIONAL INPUTS AND OUTPUTS:**

Manufactured goods can be produced under controlled conditions, designed to optimize both productivity and quality. Productivity and quality can be assured in advance. In case of services marketing, the service is delivered under uncontrollable conditions. Productivity and quality cannot be determined in advance.

**FINANCIAL INNOVATION:**

Financial intermediaries have to perform the task of financial innovation to meet the ever-changing requirements of the economy and to help the investors cope with the increasingly volatile market. Because of this reason there is a necessity for the financial intermediaries to innovate unique financial instruments.

The following are the major reasons for financial innovation:

**Low Profitability:**

Profitability refers to the ability of a financial institution to maximize profits. The profitability of the major financial institutions have been declining in the

recent times. So, the institutions are compelled to seek new products, which fetches high returns.

**Competition:**

The entry of foreign and private players in the financial services sector has led to severe competition in the industry. This has compelled the institutions to innovate the financial instruments.

**Economic Liberalization:**

Economic liberalization such as, deregulation of exchange controls and interest rate ceilings etc, have made the industry more innovative.

**Customer service:**

To cater to the needs of various customers financial institutions must be innovative. Customers desire for newer products at lower cost or lower credit risk to replace the existing ones. To meet the increased customer sophistication the financial intermediaries are constantly undertaking research to invent a new product, which suits to the requirement of the investing public.

**Global impact:**

The changes happening in the global scenario are affecting the financial services sector to a larger extent. Financial intermediaries have come out of their traditional approach and they are ready to assume more credit risks. As a consequence many innovations have taken place in the global financial sector, which have their own impact on the domestic sector also.

**Investor awareness:**

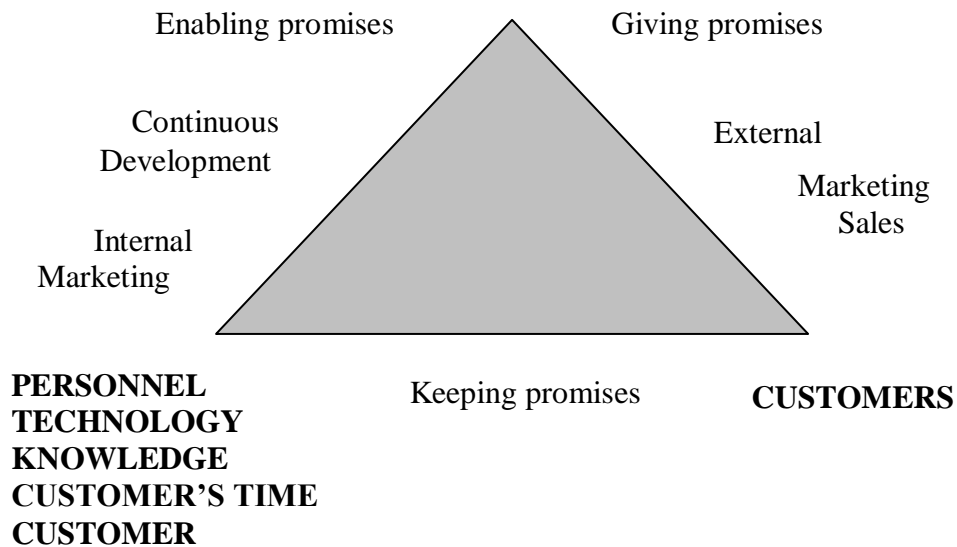
There is a degree of awareness amongst the investing public; there has been a distinct shift from investing the savings in physical assets like gold, silver, land etc. to financial assets like shares, debentures, mutual funds etc. Within the financial assets, they go from risk free bank deposits to risky investments in shares. To meet the growing awareness of the public, innovation has become the need of the hour.

**SERVICES MARKETING TRIANGLE**



## FIRM

Full-time marketers and salespeople



### The service-marketing triangle.

Source: Gronroos. C., Relationship Marketing Logic. Asia-Australia Marketing Journal.

In the above triangle the resources of a firm are divided into five groups: Personnel, Technology, Knowledge, Customer's time and the Customer.

#### **PERSONNEL:**

Many of the people representing the firm create value for customers in various service processes such as Deliveries, claims handling, service and maintenance etc. and some are directly engaged in sales and cross sales activities. These customer contact service employees are recognized as part time marketers. In many firms they outnumber the full time marketers.

#### **TECHNOLOGY:**

The knowledge that employees have and that is embedded in technical solutions and the firm's way of managing the customers' time is identified as a resource.

#### **TECHNOLOGY AND CUSTOMERS' TIME:**

The knowledge that employees have and that is embedded in technical solutions must be able to reduce the customers' time. Technology is identified as a vital element in service triangle, which emphasizes on reducing customers' time.

**KNOWLEDGE:**

A firm must acquire knowledge and competences to develop the resources needed for implementing service process in a way that creates value for each customer. A governing system is needed for the integration of various types of resources and for the management of the service processes.

**CUSTOMER:**

Customer is recognized as the King and all the efforts of the service marketer are diverted for satisfying the customer expectations. Promises given are fulfilled by using various types of resources. To enable the fulfillment of promises, continuous resource development and continuous development of competences are needed.

**QUESTIONS FOR REFERENCE:**

1. Briefly explain the nature and scope of financial services.
2. Explain conventional and modern financial services.
3. Write a brief note on Services marketing triangle.
4. Explain the differences between Goods marketing and Services marketing.
5. Explain different types of financial services?

**BOOKS FOR REFERENCE:**

1. Indian Financial System by V. A. Avadhani
2. Service Management by Christian Gronroos
3. Indian Financial system by Vasant Desai
4. Financial Markets and Services by Gordon & Natarajan

## UNIT -II

### Environment

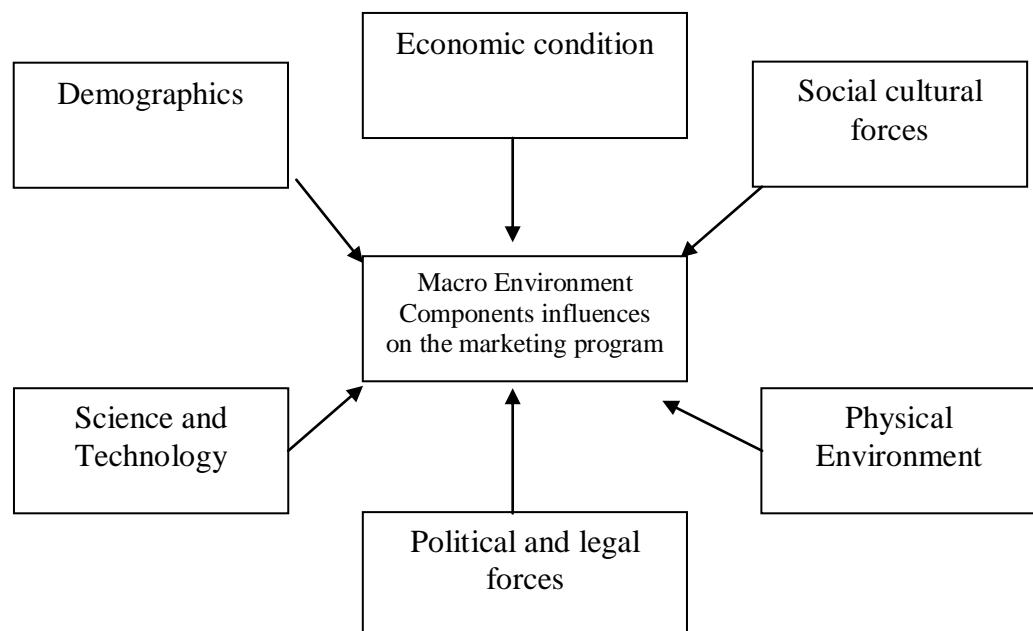
Environment refers to all external forces, which have a bearing on the functioning of business. The environment poses threats to a firm or offers immense opportunities for exploitation. Stressing this aspect, William F. Glueck and Lawrence R. Jauch wrote thus: “ The environment include factor outside the firm which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of the sectors are socio-economic, technological, supplier competitors and government”.

Marketing Environment includes all the forces outside an organization that directly or indirectly influence its marketing activities. These forces can dramatically change the course of an organization. The forces include Macro environmental forces and Micro Environmental forces.

### Macro Environment:

The Macro Environment includes the broad societal forces that shape the activities of every business and non-profit marketer. The physical environment, socio cultural forces, demographic factors, economic factors, scientific and technology factors, and political and legal factors are components of the Macro environment.

FIG. 2.1 Macro Environment Forces



### **Physical Environment**

The Physical environment consists of natural resources, such as minerals and animal populations, and other aspects of the natural world, such as changes in ecological systems. The availability of natural resources may have a direct and far-reaching impact on marketing activities in a geographic region. Areas rich in petroleum, for example, may concentrate on the production and marketing of fuel oil, kerosene, benzene, naphtha, paraffin, and other products derived from this natural resource. Marketing is influenced by many other aspects of the natural environment as well. Climate is one example. Climate also greatly influences the timing of marketing activities. In India, more than 65 percent of all soft drinks are sold during the blazing hot months of June through September, for instance. Marketers adapt their strategies to such environmental differences. Kmart, for example, identifies every item stocked in its stores by climate. It knows that climate influences not only what is purchased but when. Grass seed, insect sprays, snow shovels, and many other goods must be in the right stores at the correct time of year.

Finally, consideration of the physical environment of marketing must include an awareness of activities or substances harmful to the earth's ecology. Smog, acid rain, and pollution of the ocean are among the many issues in this category. Such issues are highly interrelated with aspects of the sociocultural environment. Green marketing is marketing ecologically safe products and promoting activities beneficial to the physical environment.

### **Natural Environment**

Marketers need to be aware of the threats and opportunities associated with four trends in the natural environment: the shortage of raw materials, the increased cost of energy, increased pollution levels, and the changing role of governments.

### **Shortage of Raw Materials**

The Earth's raw materials consist of the infinite renewable, and the finite non renewable. Infinite resources, such as air and water, pose no immediate problem, although some groups see a long run danger. Water shortages and pollution are already major problems in some parts of the world.

Finite renewable resources, such as forests and food, must be used wisely. Forestry companies are required to reforest timberlands in order to protect the soil and to ensure sufficient wood to meet future demand. Finite non-renewable resources-oil, coal, platinum, zinc, silver will pose a serious problem as the point of depletion approaches. Firms making products that require these increasingly scare minerals face substantial cost increases. They may not find it easy to pass these cost increases on to customers.

### **INCREASED ENERGY COSTS**

One finite non-renewable resource, oil, has created serious problems for the world economy. Oil prices shot up from \$ 2.23 a barrel in 1970 to \$34.00 a barrel in 1982, creating a frantic search for alternative energy forms. Coal become popular again, and companies searched for practical means to harness solar, nuclear, wind, and other forms of energy.

The development of alternative sources of energy and more efficient ways to use energy and the weakening of the oil cartel led to a subsequent decline in oil prices. Lower prices had an adverse effect on the oil exploration industry but considerably improved the income of oil-using industries and consumers. In the mean time, the search continues for alternative sources of energy.

### **Increased Pollution levels**

Some industrial activity will inevitably damage the natural environment. Consider the dangerous mercury levels in the ocean, the quantity

of DDT and other chemical pollutions in the soil food supply, and the littering of the environment with bottles, plastics, and other packaging materials.

Research has shown that about 42 percent of U.S. consumers are willing to pay higher prices for “green” products. This willingness creates a large market for pollution-control solutions, such as scrubbers, recycling centers, and landfill systems. Smart companies are initiating environment – friendly moves to show their concern.

### **Changing Role of Governments**

Governments vary in their concern and efforts to promote a clean environment. For example, the German Government is vigorous in its pursuit of environmental quality, partly because of the strong green movement in Germany and partly because of the ecological devastation in the former East Germany. The major hopes are that companies around the world will accept more social responsibility and that less expensive devices will be invented to control and reduce pollution.

### **Sociocultural Forces**

Every society has a culture that guides everyday life. In the environment of marketing, the world culture refers not to classical music, art, and literature but to social institutions, values, beliefs, and behaviours. Culture includes everything people learn as members of a society, but does not include the basic drives with which people are born.

Culture is shaped by humankind. It is learned rather than innate. For example, people are born with a need to eat – but what, when, and where they eat, and whether they season their food with ketchup or curdled goat’s milk is learned from a particular culture.

### **Values and beliefs**

A social value embodies the goals a society views as important and expenses a culture’s share ideas of preferred ways of acting. Social values

reflect abstract ideas about what is good, right, and desirable (and bad, wrong, and undesirable). For example, we learn from those around us that it is wrong to lie or steal. The following social values reflect the beliefs of most people in the United States.

*Freedom.* The freedom of the individual to act as he or she pleases is a fundamental aspect of U.S. culture.

*Achievement and success.* The achievement of wealth and prestige through honest efforts is highly valued. Such achievement leads to a higher standard of living and improves the quality of life.

*Work ethic.* The importance of working on a regular basis is strongly emphasized. Those who are idle are considered lazy.

*Equality.* Most Americans profess a high regard for human equality, especially equal opportunity, and generally relate to one another as equals.

*Patriotism/nationalism.* Americans take pride in living in the ‘best country in the world.’ They are proud of their country’s democratic heritage and its achievements.

*Individual responsibility and self-fulfilment.* Americans are oriented toward developing themselves as individuals. They value being responsible for their achievements. The U.S. Army’s slogan “Be all that you can be” captures the essence of the desirability of personal growth.

A **belief** is a conviction concerning the existence or the characteristics of physical and social phenomena. A person may believe, for example, that a height-fat diet causes cancer or that chocolate causes acne. Whether a belief is correct is not particularly important in terms of a person’s actions. Even totally foolish beliefs may affect how people behave and what they buy. It is the marketer’s job to “read” the social environment and reflect the surrounding culture’s values and beliefs in a marketing strategy. Social values are changing

to play down work and to focus on family and on emotional enhancement of personal life. Values and beliefs vary from culture to culture.

### **Demographics**

The terms *demography* and *demographics* come from the Greek word  *demos*, meaning “people” (as does the word democracy). **Demography** may be defined as the study of the size, composition (for example, by age or racial group), and distribution of the human population in relation to social factors such as geographic boundaries. The size, composition, and distribution of the population in any geographic market will clearly influence marketing. Because demographic factors are of great concern to marketing managers.

The first macroenvironmental force that marketers monitor is population because people make up markets. Marketers are keenly interested in the size and growth rate of population in different cities, regions, and nations; age distribution and ethnic mix; educational levels; household patterns; and regional characteristics and movements.

#### Worldwide Population Growth

The World population is showing “explosive” growth. The world population explosion has been a source of major concern, for two reasons. The first is the fact that concern resources needed to support this much human life (fuel, foods, and minerals) are limited and may run out at some point.

The second cause for concern is that population growth is highest in countries and communities that can least afford it. The less developed regions of the world currently account for 76 percent of the world population and are growing at 2 percent per year, whereas the population in more developed countries is growing at only 0.6 percent per year. In the developing countries, the death rate has been falling as a result of modern medicine, but the birthrate has remained fairly stable. Feeding, clothing and educating their children while also providing a rising standard of living is nearly impossible in these countries.



The explosive world population growth has major implications for business. A growing population does not mean growing markets unless these markets have sufficient purchasing power. Nonetheless, companies that carefully analyze their markets can find major opportunities. For example, to curb its skyrocketing population; the Chinese government has passed regulations limiting families to one child per family. Toy marketers, in particular, are paying attention to one consequence of these regulations.

#### Population Age Mix

National populations vary in their age mix. A Population can be subdivided into six age groups: preschool, school-age children, teens, young adults age 25 to 40, middle-aged adults age 40 to 65, and older adults age 65 and up. For marketers, the most populous age groups, shape the marketing environment.

#### Ethnic Markets

Countries also vary in ethnic and racial makeup. At one extreme is Japan, where almost everyone is Japanese; at the other is the United States, where people from come virtually all nations. The United States was originally called a “melting pot,” but there are increasing signs that the melting didn’t occur. Now people call United States a “salad bowl” society with ethnic groups maintaining their ethnic differences, neighbourhoods, and cultures. The U.S. population (267 million in 1997) is 73 percent white. African Americans constitute another 13 percent, and Latinos another 10 percent. The Latino population has been growing fast, with the largest subgroups of Mexican (5.4 percent), Puerto Rican (1.1 percent) and Cuban (0.4 percent) descent. Asian Americans constitute 3.4 percent of the U.S. population, with the Chinese constituting the largest group, followed by the Filipinos, Japanese, Asian Indians, and Koreans, in that order. Moreover, there are nearly 25 million

people living in the United States – more than 9 percent of the population--- who were born in another country.

Each group has certain specific wants and buying habits. Several food, clothing, and furniture companies have directed their products and promotions to one or more of these groups.

### Educational Groups

The population in any society falls into five educational groups; illiterates, high school dropouts, high school degrees, college degrees, and professional degrees. In Japan, 99 percent of the population is literate, whereas in the United States 10 percent to 15 percent of the population may be functionally illiterate. However, the United States has one of the world's highest- percentages of college-educated citizenry, around 36 percent. The high number of educated people in the United States spells a high demand for quality books, magazines, and travel.

### Household Patterns

The “traditional household” consists of a husband, wife and children (and sometimes grandparents). Yet, in the United States today, one out of eight households are “diverse” or “non-traditional” and include single live-alones, adult live-togethers of one or both sexes, single-parent families, childless married couples, and empty nesters. More people are divorcing or separating, choosing not to marry, marrying later, or marrying without the intention to have children. Each group has a distinctive set of needs and buying habits.

The gay market, in particular, is a lucrative one. Insurance companies and financial services companies are now waking up to the needs and potential of not only the gay market but also the non-traditional household market as a whole:

### Geographical Shifts in Population

This is a period of great migratory movements between and within countries. Since the collapse of soviet eastern Europe, nationalities are reasserting themselves and forming independent countries. The new countries are making certain ethnic groups unwelcome (such as Russians in Latvia or Muslims in Serbia), and many of these groups are migrating to safer areas. As foreign groups enter other countries for political sanctuary, some local groups start protesting. In the United states, there has been opposition to the influx of immigrants from mexico, the Caribbean, and certain asian entrepreneurs are taking advantage of the growth in immigrant populations and marketing their wares specifically to these new members of the Population.

#### Shift from a Mass Market to Micro markets

The effect of all these changes is fragmentation the mass market into numerous micro markets differentiated by age, sex, ethnic background, education, geography, lifestyle, and other characteristics. Each group has strong preferences and is reached through increasingly targeted communication and distribution channels. Companies are abandoning the “shotgun approach” that aimed at a mythical “average” consumer and are increasingly designing their products and marketing programs for specific micro markets.

### **ECONOMIC ENVIRONMENT**

Markets require purchasing power as well as people. The available purchasing power in an economy depends on current income, prices, savings, debt, and credit availability. Marketers must pay close attention to major trends in income and consumer spending patterns.

#### **Income Distribution**

**Nations vary greatly in level and distribution of income and industrial structure. There are four types of industrial structures.**

1.*Subsistence economics*: In a subsistence economy, the vast majority of people engage in simple agriculture, consume most of their output, and barter the rest

for simple goods and services. These economics offer few opportunities for marketers.

2. *Raw-material-exporting economics*: These economics are rich in one or more natural resources but poor in other respects. Much of their revenue comes from exporting these resources. Examples are Zaire (copper) and Saudi Arabia (oil). These countries are good markets for extractive equipment, tools and supplies, materials-handling equipment, and trucks. Depending on the number of foreign residents and wealthy native rulers and landholders, they are also a market for Western-style commodities and luxury goods.

3. *Industrializing economics*: In an industrializing economy, manufacturing begins to account for 10 percent to 20 percent of gross domestic product. Examples include India, Egypt, and the Philippines. As manufacturing increases, the country relies more on imports of finished textiles, paper products, and processed foods. Industrialization creates a new rich class and a small but growing middle class, both demanding new types of goods.

4. *Industrial economics*: Industrial economies are major exporters of manufactured goods and investment funds. They buy manufactured goods from one another and also export them to other types of economies in exchange for raw materials and semi finished goods. The large and varied manufacturing activities of these nations and their sizable middle class make them rich markets for all sorts of goods.

Marketers often distinguish countries with five different income – distribution patterns: (1) very low incomes; (2) mostly low incomes; (3) very low, very high incomes; (4) low, medium, high incomes; and (5) mostly medium incomes.

### **Savings, Debt, and Credit Availability**

Consumer expenditures are affected by consumer savings, debt, and credit availability. The Japanese, for example, save about 13.1 percent of their income, whereas U.S. consumers save about 4.7 percent. The result has been that Japanese banks were able to loan money to Japanese companies at a much lower interest rate than U.S. banks could offer to U.S. companies. Access to lower interest rates helped Japanese companies expand faster. U.S. consumers also have a high debt-to-income ratio, which slows down further expenditures on housing and large ticket items. Credit is very available in the United States but at fairly high interest rates, especially to lower income borrowers. Marketers must pay careful attention to major changes in incomes, cost of living, interest rates, savings, and borrowing patterns because they can have a high impact on business, especially for companies whose products have high income and price sensitivity.

A society's economic system determines how it will allocate its scarce resources. Traditionally, capitalism, socialism, and communism have been considered the world's major economic systems. In general, the western world's economics can be classified as modified capitalist systems. Under such systems, competition, both foreign and domestic, influences the interaction of supply and demand. Competition is often discussed in this context in terms of competitive market structures.

The competitive structure of a market is defined by the number of competing firms in some segment of an economy and the proportion of the market held by each competitor. Market structure influences pricing strategies and creates barriers to competitors wishing to enter a market. The four basic types of competitive market structure are pure competition, monopolistic competition, oligopoly, and monopoly.

Pure competition exists when there are no barriers to competition. The market consists of many small, competing firms and many buyers. This means that there is a steady supply of the product and a steady demand for it. Therefore, the

price cannot be controlled by either the buyers or the sellers. The product itself is homogeneous-that is, one seller's offering is identical to all others' offerings. The markets for basic food commodities, such as rice and mushrooms, approximate pure competition.

The principal characteristic of monopolistic competition is product differentiation-a large number of sellers offering similar products differentiated by only minor differences in, for example, product design, style, or technology. Firms engaged in monopolistic competition have enough influence on the marketplace to exert some control over their own prices. The fast-food industry provides a good example of monopolistic competition.

**Oligopoly**, the third type of market structure, exists where a small number of sellers dominate the market.

Finally, markets with only one seller, such as a local telephone company or electric utility, are called monopolies. A monopoly exists in markets which there are no suitable substitute products.

### **Economic conditions**

Economic conditions around the world are obviously of interest to marketers. The most significant long-term in the U.S. economy has been the transition to a service economy. There has been a continuing shift of workers away from manufacturing and into services, where almost 80 percent of U.S. jobs are to be found. This shift has greatly affected economic conditions as well as marketing activity.

### **THE BUSINESS CYCLE**

The business cycle reflects recurrent fluctuations in general economic activity. The various booms and busts in the health of an economy influence unemployment, inflation, and consumer spending and saving patterns, which, in turn, influence marketing activity. The business cycle has four phases:

- Prosperity – the phase in which the economy is operating at or near full employment and both consumer spending and business output are high.
- Recession – the download phase, in which consumer spending, business output, and employment are decreasing.
- Depression – the low phase, in which unemployment is highest, consumer spending is low, and business output had declined drastically.
- Recovery – the upward phase, when employment, consumer spending, and business output are rising.

Because marketing activity, such as the successful introduction of new products is strongly influenced by the business cycle, marketing managers watch the economic environment closely. Unfortunately, the business cycle is not always easy to forecast. The phases of the cycle need not be equal in intensity or duration, and the contractions and expansions of the economy do not always follow a predictable pattern. Furthermore, not all economies of the world are in the same stage of the business cycle. So a single global forecast may not accurately predict activity in certain countries.

Marketing strategies in a period of prosperity differ substantially from strategies in a period of depression.

#### The Health of a Country's Economy

**Two common measures of the health of a country's economy are gross domestic product (GDP) and gross national product (GNP). The GDP measures the value of all the goods and services produced by workers and capital in a country. The GNP measures the value of all the goods and services produced by a country's residents or corporations, regardless of their location.**

#### Political Legal Environment

**The political environment - the practices and policies of governments – and the legal environment - laws and regulations and their interpretation- affect marketing activity in several ways. First, they can limit the actions marketers are allowed to take – for example, by barring certain goods from leaving a country, as when Congress passed the Export Administration Act, which prohibited the export of strategic high-technology products to nations such as Iran and Libya. Second, they may require marketers to take certain actions. For instance, cookies called “chocolate chip cookies” are required to contain chips made of real chocolate, and the surgeon general’s warning must appear on all cigarette packages. Last, policies and laws may absolutely prohibit certain actions by marketers – for example, the sale of products such as narcotic drugs and nuclear weapons –except under the strictest of controls. Political processes in other countries may have a dramatic impact on international marketers.**

Political and Legal forces

**Every company’s conduct is influenced, often a great deal, by the political and legal processes in our society. The political and legal forces on marketing can be grouped into the following four categories.**

- ***Monetary and fiscal policies.*** Marketing efforts are affected by the level of government spending, the money supply, and tax legislation.
- ***Social legislation and regulations.*** Legislation affecting the environment –antipollution laws, for example – and regulations set by the Environmental Protection Agency fall into this category.
- ***Governmental relationships with industries.*** Here we find subsidies in agriculture, shipbuilding, passenger rail transportation, and other industries. Tariffs and import quotas also affect specific industries.



**Government deregulation continues to have an effect on financial institutions and public utilities (such as electric and natural gas suppliers) as well as on the telecommunications and transportation industries.**

- ***Legislation related specifically to marketing.* Marketing executives do not have to be lawyers, but they should know something about laws affecting marketing – why they were passed, their main provisions, and current ground rules set by the courts and regulatory agencies for administering them.**

**Up to this point, our discussion of political and legal forces affecting marketing has dealt essentially with the activities of the *federal* government. However, there are also strong political and legal influences at the *state and local* levels. For instance, many firms' marketing programs are affected by zoning requirements, interest-rate regulations, state and local taxes, prohibitions against unsubstantiated environmental claims, and laws affecting door-to-door selling. All of these have been put in place by numerous states and municipalities.**

### Science and Technology

Although the two terms are sometimes used interchangeably, **science** is the accumulation of knowledge about human beings and the environment, and **technology** is the application of such knowledge for practical purposes. Thus, the discovery that certain diseases can be prevented by immunization is a scientific discovery, but how and when immunization is administered is a technological issue.

Like other changes in the macro environment, scientific and technological advances can revolutionize an industry or destroy one. Examples of organization that suffered because they did not adapt to changing technology are easy to find.

Western Union's telegrams, which were sent by an electromechanical device, were made obsolete by telephones, computers, and fax machines. More recently, Atari and several other marketers of video games fell victim to competitors, such as Sony Playstation and Nintendo, that were more technologically advanced, with higher-performance microprocessors.

## **DIGITAL TECHNOLOGY AND THE INTERNET: CHANGING EVERYTHING**

Historians and anthropologists have pointed out that technological innovations can change more than the way business is done in an industry. Indeed, major technological innovations can change entire cultures. For example, the mechanical clock made regular working hours possible. The invention of the steam engine and rail roads and the mass production of automobiles changed the way people thought about distance—the words *near* and *far* took on new meaning. Television changed the way people think about news and entertainment.

“Today's computer technology can be characterized by the phrase *digital convergence*. Almost all industries, profession, and trades are being pulled closer together by a common technological bond: the digitising of the work product into the ones and zeros of computer language. Digital technology, especially the Internet, is having such a profound impact on marketing and society that it deserves special attention.

## **THE INTERNET**

The Internet is worldwide network of computers that gives users access to information and documents from distant sources. People using the Internet may be viewing information stored on a host computer halfway around the world. The World Wide Web (WWW) refers to a system of Internet servers, computers supporting a retrieval system that organizes information into

Hypertext documents called Web pages. (Hypertext is a computer language that allows the linking and sharing of information in different formats. HTTP [Hyper Text Transfer Protocol] is the most commonly used method for transferring and displaying information formatted in HTML [Hyper Text Mark-up Language] on the Internet.)

In our prologue, we said that the Internet is transforming society. Time is collapsing. Distance is no longer an obstacle. “Instantaneous” has a new meaning. Our intent was to impress on the reader that the Internet is the most important communication medium to come along since television. The Internet, as a new medium for our new era, is a macro environmental force that is having a profound impact.

We are among those who believe that the Internet is changing everything-especially commerce. We firmly believe that e-commerce is the business model for the new millennium and that marketing’s role has been changed forever by the Internet. This does not mean that the familiar neighbourhood brick-and-mortar stores and all traditional marketing institution like shopping centres will disappear, but it does mean that they will adapt and change as new forms of Internet marketing become more prevalent.

## PORTALS

As you probably know, over the past few years, most major corporations, government agencies, universities, newspapers, TV networks, and libraries have set up e-mail systems and Web sites. The introductory page or opening screen, of a web site is called the *home page*. The home page provides basic information about the purpose of the website, along with a “menu” of selections, or links, that lead to other screens with more specific information. Thus, each page can have connections, or hyperlinks, to other pages, which may be on the organization’s own computer or on any computer connected to the Internet.

The Internet can be thought of as the world’s largest public library. This means that the Internet user can be faced with retrieval and filtering burden-it

takes time to search various Web sites and determine if the information you want is there. To solve this problem, many companies such as Yahoo!, Excite, Snap, and Go Network have established themselves as portals to the Internet. A portal is a Web site that offers a broad array of resources and services, such as news services, search engines, e-mail, discussion forums, and online shopping. The first portals were online service providers (for example, America online), but now most service providers with search engines have transformed themselves into Web portals. Many marketers view the portal business as a media business that can attract and retain a larger audience.

Internet illustrates, scientific and technological forces have a pervasive influence on the marketing of most goods and services. Because changes related to science and technology can have a major impact, organizations of all types must monitor these changes and adjust their marketing mixes to meet them.

### Technology

Technology has a tremendous impact on our lifestyles, our consumption patterns, and our economic well-being. Just think of the effect of technological developments such as the airplane, plastics, television, computers, antibiotics, lasers, and-of course-video games. Except perhaps for the airplane, all these technologies reached their major markets in your lifetime or your patterns' life time. Think how your life in the future might be affected by cures for the common cold, development of energy sources to replace fossil fuels, low-cost methods of making ocean water drinkable, or even commercial travel to the moon.

Technological breakthroughs can affect markets in three ways:

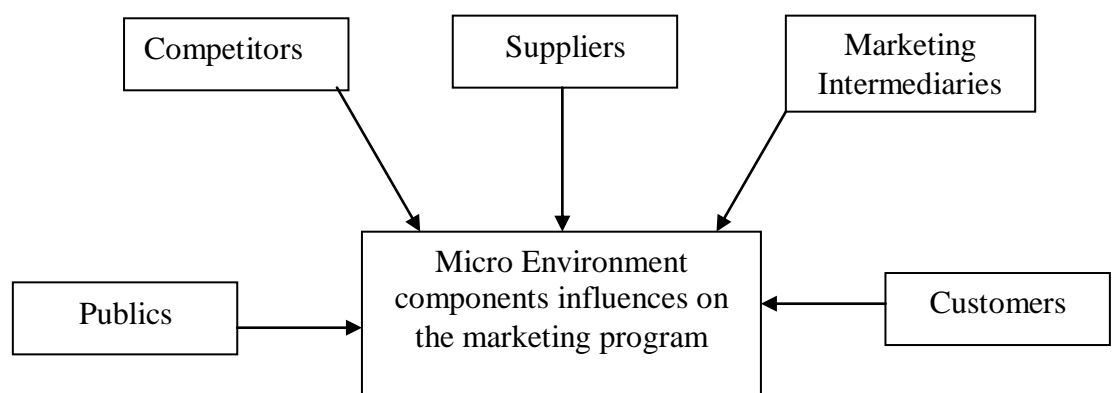
- By starting entirely new industries, as computers, lasers, and robots have done.

- By radically altering, or virtually destroying, existing industries. When in first came out, television crippled the radio and movie industries. And computers all but replaced typewriters.
- By simulating markets and industries not related to the new technology. New home appliances and microwavable foods give people additional time in which to engage in other activities.

Advances in technology also affect how marketing is carried out. We should also note that technology is a mixed blessing in some ways. A new technology may improve our lives in one area while creating environmental and social problems in other areas. Television and video games provide built in child care, but they are criticized for reducing family discussions and reading by children. The automobile is a convenient form of personal transportation, but it also creates traffic jams and air pollution. In turn, technology is expected to solve some problems it is criticized of having caused (air pollution, for example).

### **Micro Environment:**

The microenvironment consists of the actors of the company's immediate environment that affect the performance of the company. There include the suppliers, Marketing intermediaries, competitors, customers and publics. The micro environment forces need not necessarily affect all the firms in a particular industry, in the same way, some of the micro factors may be particular to a firm for example; a firm which depend on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. It is quite obvious that the microenvironment factors are more intimately linked with the company than the macro factors.



## **Fig. 2.2 Micro Environment Forces**

### **Suppliers**

An important force in the micro environment of a company is the suppliers, i.e., those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply of the smooth functioning of the business is obvious. Uncertainty regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increases.

Because of the sensitivity of the supply, many companies give high importance to vendor development. Vertical integration, where feasible, helps solve the supply problem.

It is very risky to depend on a single supplier because a strike, lock out or any other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behaviour of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.

The supply management assumes more importance in a scarcity environment. "Company purchasing agents are learning how to "Wine and dine" suppliers to obtain favourable treatment during periods of shortages. In other words, the purchasing department might have to "market" itself to suppliers".

A business cannot sell a product without being able to make or buy it. That's why the people or firms that supply the goods or services required by a producer to make what it sells are critical to marketing success. So too are the

firms that provide the merchandise a wholesaler or retailer resells. And that's why we consider a firm's suppliers a vital part of its marketing environment.

Marketing executives often are not concerned enough with the supply side of marketing. However, when shortages occur, they recognize the need for cooperative relationships with suppliers. Further, as online sales rise, Internet companies are paying much more attention to sources of supply and also the methods by which orders will be processed and delivered to buyers.

### **Customers**

As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success.

A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. For example the customers of a type company may include individual automobile owners, automobile manufactures, public sector transport undertakings and other transport operators.

Depending on a single customer is often too risky because it may place the company in a poor bargaining position, apart from the risks of losing business consequent to the winding up of business by the customer or due to the customer's switching over to the competitors of the company.

The choice of the customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition.

### **Consumers**

Although a company has control over its selection of a target market, it cannot control the characteristics of the population. Firms can react to, but not control, such consumer characteristics as these: age, income, marital status,

occupation, race, education, and place and type of residence. For example, although Gerber can develop new baby foods, it cannot stop the slowdown in the number of U.S. births. To continue growing, Gerber has had to expand into other goods and services (such as life insurance).

A firm must understand the interpersonal influences on consumer behaviour. Consumers' purchases are affected by their family, friends, religion, and other social contacts-and by the customs and taboos shaping a culture and society. For instance, in some parts of the United States, store hours are restricted, liquor sales are strictly regulated (as to prices, other goods that can be sold, and days open), and movies are closely rated. In other parts, stores are regularly open for long hours, seven days a week; liquor is sold in many types of outlets; and any movie can be shown uncut.

Because consumers act differently in purchasing various types of goods and services, a firm needs to comprehend the consumer's decision-process the steps a person goes through when buying a product. In the case of a car, a consumer carefully searches for information on a number of models, ranks several alternatives, selects a favourite, negotiates terms, and finally completes the purchase. With an inexpensive restaurant meal, a person looks at a watch, sees it is lunchtime, and goes to nearby first-food outlet.

Today, consumer-rights groups and organizations speak out on behalf of consumers at public hearings, Stockholder meetings, and before the media. To avoid negative consequences brought on by active consumer groups, a firm must communicate with consumers on relevant issues (such as a product recall), anticipate problems (such as delays in shipping ordered goods), respond to complaints (such as unsatisfactory customer service), and make sure it has good community relations (such as sponsoring neighbourhood projects).

## **Competition**



To a particular business, competition usually refers to firms that market similar or substitutable products in the same geographic area. In general, the term competition refers to the rivalry among businesses for consumer dollars. For example, the manager of a university bookstore views all bookstores near the university as competition but probably does not think university bookstores in other geographic areas as competition. In general, all the bookstores near the university compete for students' dollars.

In developing and implementing a marketing program, an organization must consider the type of competition in its markets and assess the actions of its competition.

### **Type of Competition**

The number of organizations that sell a product may affect the strength of competition. When there are many businesses selling a particular product, for example, price considerations and product differences are more important than when only one business is selling that product. The number of firms selling a similar product determines the structure of the market.

A monopoly exists when only one firm markets a product for which there are no close substitutes. The firm has complete control over the supply of the product. Although monopolies are generally discouraged, the United States government allows utility companies, such as Commonwealth Edison Co. and Cooke Cablevision, to have monopolies in providing electricity, cable television, and other utilities because the costs of operating such businesses are too high for most organizations to enter those markets.

An oligopoly exists when few firms are marketing a product and they control much of the supply of the product. Products in oligopolistic competition may be homogeneous (similar or uniform in nature), such as coal or steel, or differentiated (having real or perceived differences), such as cigarettes or airline services. In an oligopoly, each seller must consider the reactions of other sellers to changes in marketing activities. During the airlines price wars of the 1980s,

for example, whenever Continental Airlines Corp. reduced its fares, other air carriers had to follow suit to remain competitive.

Monopolistic competition exists when many firms are marketing a product; each firm attempts to difference its product to convince consumers that its product is the one to buy. For example, Apple Computer, Inc., has established a differential advantage for its computers through a well-known design, advertising, and a user – friendly image. Although many other brands of computers are available, Apple has carved out its share of the market through use of a differential marketing strategy.

Perfect competition, if it existed, would be a market with a large number of sellers, no one of which could significantly influence the price or supply of the products. Products would be homogeneous, and potential sellers of the products would have full knowledge of the market and easy entry into it. There is no market with perfect competition because social and economic factors make it impossible for all buyers and sellers to have complete information about the products. The closest example of perfect competition is the market for agricultural products such as corn, cotton, and soybeans.

### **Assessing Competition**

Business needs to monitor the actions of their competition and assess the changes their competitors are making. For example, a marketing manager should determine if, and why, major competitors are changing prices, product designs, warranties and service policies, packaging, distribution methods, or promotional factors such as sales force size and advertising. Knowledge of such changes helps the marketing manager to decide what adjustments to make to current marketing strategies and how to plan new ones. Marketers can obtain information about changes their competitors are making from direct observation, salespeople, customers, trade journals, marketing research, and distributors.

### **Marketing intermediaries**

The immediate environment of a company may consist of number marketing intermediaries which are “firms that aid the company in promoting, selling and distributing its goods to final buyers”

The marketing intermediaries include middlemen such as agents and merchants who “help the company find customers or close sales with them” Physical distribution firms which “assist the company in stocking and moving goods from their origin to their destination” such as warehouses and transportation firms; marketing service agencies which “assist the company in targeting and promoting its products to the right markets” such as advertising agencies, marketing research firms, media firms, and consulting firms; and financial intermediaries which finance marketing activities and insure business risks. Marketing intermediaries are vital links between the company and the final consumers.

Marketing intermediaries are independent business organizations that directly aid in the flow of goods and services between a marketing organization and its markets. There are two types of intermediaries :(1) the firms we call *middle men* – wholesalers and retailers, and (2) various *facilitating organization* furnishing such services as transportation, warehousing and financing that are needed to complete exchanges between buyers and sellers. These intermediaries operate between a company and its markets and between a company and its suppliers. Thus they are part of what we call *channels of distribution*.

In some cases, it may be more efficient for a company to not use marketing intermediaries. A producer can deal directly with its suppliers or sell directly to its customers and do its own shipping, financing, and so on. But marketing intermediaries are specialists in their respective fields. They often do a better job at a lower cost than the marketing organization can do by itself.

Collectively, the company, its suppliers and its intermediaries (both middlemen and facilitating organizations) comprise a value chain. That is, all of these enterprises–each in its own way–perform activities to add value to the

product that is eventually bought by an individual or an organization. It's relatively easy to comprehend the value added by a manufacturer when it combines various materials to form a finished product. But it's more difficult to detect the value added by other members of the value chain. For example, consider a financial institution that agrees to provide credit to consumers who buy vehicles from an auto dealership. This facilitating organization has added value to the product, essentially by making it easier for a prospective buyer to make a purchase.

### **Publics**

A company may encounter certain publics in its environment. "A public is any group that has an actual or potential interest in or impact on an organization's ability to achieve its interests" Media publics, citizens action publics and local publics are some examples.

Some companies are seriously affected by such publics. For example, one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily which was allegedly bent on bringing down the share prices of the company by tarnishing its image. Such exposures or campaigns by the media might even influence the government decisions affecting the company. Many companies are also affected by local publics. Environmental pollution is an issue often taken up by a number of local publics. Actions by local publics on this issue have caused some companies to suspend operations and/or take pollution abatement measures.

Growth of consumer publics is an important development affecting business. It is wrong to think that all public are threats to business. Some of the actions of publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, for example, regard consumerism as an opportunity for the business. The media public may be used to disseminate useful information. Similarly, fruitful cooperation between a

company and the local public may be established for the mutual benefit of the company and the local community.

### **MONITORING THE MARKETING ENVIRONMENT:**

The marketing environment is dynamic it is always changing. Whether the forces of the marketing environment fluctuate slowly or rapidly, they create uncertainty, obstacles, and opportunities. Marketers must constantly monitor the marketing environment to be prepared to capitalize on opportunities and minimize adverse conditions. To monitor changes in the marketing environment effectively, marketing managers must engage in environmental scanning and analysis.

#### **Environmental Analysis:**

Environmental analysis is the process of assessing and interpreting the information gathered through environmental scanning. A manager reviews the information for accuracy, tries to reconcile inconsistencies in the data, and interprets the findings. Analysis allows a marketing manager to discern changes in the environment and, if possible, or predict future changes. By evaluating these changes, a marketing manager should be able to determine possible threats and opportunities associated with environmental fluctuations. Knowledge of current and predicted environmental changes aids a marketing manager in assessing the performance of current marketing efforts and in developing marketing strategies for the future.

#### **Approaches for Responding to Environmental Forces:**

In responding to environmental forces, marketers use one of two general approaches. In the first approach, marketing managers view the forces of the marketing environment as uncontrollable. According to this traditional approach, an organization can do little to alter the influence of the taking this reactive approach tries to prepare itself to respond quickly to changes in the environment. For example, although an organization has little power to alter

economic conditions new regulations, or the actions of competitors, it can monitor the environment closely and adjust its marketing strategy to counter the effects of inflation, a new product safety law, or product improvements by competitors.

A second response to the marketing environment is to take a proactive, or aggressive, stance toward environmental forces. A growing number of marketing professionals argue that the forces of the marketing environment can be controlled, at least to some extent. They believe that marketing itself represents a significant force that can be used to create change and extend its influence over the environment. Through lobbying, legal action, advertising of key issues, and public relations, organisations can alter some environmental forces. For instance, a firm can control its competitive environment by using aggressive pricing or competitive advertising strategies to influence the decisions of rival firms. It can lobby political officials to repeal legislation that it believes will restrict its business. Likewise, a firm can use political skills and public relations activities to open foreign markets to American business.

Neither response to environmental forces is superior. For some organisations, the reactive approach is more appropriate; for other firms, the proactive approach leads to better performance. The selection of a particular approach is determined by an organisation's managerial philosophies, objectives, financial resources, markets and human skills, and by the composition of the set of environmental forces within which the organisation operates.

## **UNDERSTANDING FINANCIAL SERVICES CUSTOMER**

The consumer is the central focus of marketing. Thus to develop successful marketing plans. It is necessary to examine consumer characteristics and needs, life-style and purchase processes and then structure marketing mix decisions accordingly.

The scope of consumer analysis included the study of who buys, what they buy, why they buy, how they buy, when they buy, how often they buy. By

analysing consumer, a firm is better able to determine the most appropriate audience to which will appeal and the combination of marketing factors that will satisfy this audience. The Basis concepts necessary for understanding consumers, selecting target markets, and relating marketing strategy to consumer behaviour are detailed. It also examine final consumer demographics. Social and psychological characteristics and decision making. Final consumers purchase goods and services for personal, family or household use. The organisational consumer buy for production, operation or resale.

### **CONSUMER DEMOGRAPHIC PROFILE :**

Consumer demographics are easily identifiable and measurable population characteristics consumer demographics and objective and quantifiable population characteristics. They are easy to identify collect, measure and analyse. The demographics data are available from many secondary sources. Several secondary sources offer extensive information on consumer demographics. The most important significant source is the census of population. These are different factors determining a consumer demographic profile.

### **Population size, Gender, and Age:**

The population size refers the substantial market for all types of goods and services. The companies need to focus efforts and appeal to more mature markets. Population gender and age will and influence on buying behaviour.

### **Location, Housing and Mobility :**

Location, Housing and mobility is the important factor influencing the buying behaviour. The mobility of the population varies by geographic region. The density of population makes marketing programmes more cost efficient and

available to larger groups of consumers opportunities for mass distribution and advertising are plentiful.

**Income and Expenditures:**

Income is the most powerful economic factor that influences consumer behaviour. Income is the return of one's economic endeavours. It gives purchasing power to consumers which help them strike an exchange, create a purchase sales transaction.

**Occupation and Education:**

Occupation and Education influence purchasing behaviour. The education influence how decisions are made. Educated consumers seek more information and better quality product. Today the trend is towards white collar and service occupations is continuing. It have great impact on buying behaviour.

**Martial Status:**

Marriage and family remain powerfull tool in influencing buying behaviour. The family unit can influence the particular type of products purchased. A family has related person residing together. A household has one or more persons who may not be related.

Thus a consumer demographic profile combines individual demographic factors. The consumer demographics are objective and quantifiable population statistics. They include population size, gender, age, location, housing mobility, income, expenditures, occupation, education and martial status.

**Consumer Life-Style :**

A consumer's life-style represents the way in which a person lives and spend s time and money. It is a function of the social and psychological factors that have been internalized by that person.

Consumer life-style describes how people live and can be measured by psychographics. Psychographics is the technique that classifies consumer life-style by investigating how people, what interest them and what they like. An



AIO (activities, interests, and options) inventory is used in psychographic research to determine consumer life-style. The social aspects of life-style include culture, social class, social performance, reference groups, opinion leaders, the family life cycle and time expenditures. The psychological aspect of life-style include personality, attitudes, the levels of class conscious, motivation, perceived risk innovativeness and the importance purchase. The Social and psychological factor overlap and complement each other they are not independent or exclusive of one other.

### **SOCIAL CHARACTERISTICS OF CONSUMER:**

The social profile of a consumer is based on a combination of culture, social class, social performance, reference groups, opinion leaders, family life cycle and time expenditure.

#### **Culture:**

The culture has an considerable influence on consumer behaviour. Culture consists of the acquired or cultivated behaviour and thought of individuals within a society, as well as of intellectual, artistic and social ideas and institution which the member of the society profess and to which they strive to conform. The culture affects motives, brand comprehension, attitude and intentions to purchase. Culture consists essentially of traditional ideas and in particular values which are attached to these ideas social class.

#### **Social class**

Social class separates society into divisions. A social class system reflects a status hierarchy by which groups and individual are classified in the basis of esteem and prestige. Such a system separates society into divisions, grouping people with similar values and life-styles. Social class are based on such attributes as income, occupation, education and type of dwelling. Each social class may represent a district target market for a firm.

#### **Social Performance:**

Social performance describes how a person fulfils his or her roles. Social performance is how a person carries out his or her roles as a worker, family member, citizen, and friend. At one extreme, a person may be a vice-president in a company, have a happy family life, be an active member of the community and have many friends. At the other extreme, a person may never be promoted higher than assistant manager, be divorced, not participate in community affairs, and have few friends. It should be clear that many combinations of these performance criteria are possible for example vice-president and divorced.

**Reference Group:**

A reference group is one that influences a person's thoughts or actions. It may be aspirational, membership, or dissociative. An aspirational group is one to which a person does not belong but wishes to belong, such as a fraternity, professional society, or social club. A membership group is one to which the person does belong, such as a family, union, or "working women". A dissociative group is one to which the person does not want to belong, such as an unpopular social group, school dropouts, or a low achievement group.

For many goods and services, reference groups have a considerable impact on purchase behaviour. Face-to-face reference groups, such as family or fraternity, have the most influence on a person. Yet, other more general reference groups also influence behaviour and these are frequently appealed to when marketing products.

**OPINION LEADERS:**

Opinion leader affect other through face to face contact. Opinion leaders, these are people to whom other consumers turn for advice and information via fact to face communication. Opinion leaders tend to be expert about a product category, socially accepted, long-standing members of the community, gregarious, active, and trusted, and they tend to seek approval from others. Opinion leaders normally have an impact over a narrow range of

products: they are perceived as more credible than company sponsored sources of information.

### **The Family Life Cycle :**

The family life cycle describes family stages, which often use joint decision making. The family life cycle describes how a family evolves through various stages from bachelorhood to solitary retirement. At each stage, needs, experience, income, and family composition change. In addition, the use of **joint decision making** the process whereby two or more consumers have input into purchases changes throughout the cycle. The family life cycle is an excellent tool for market segmentation and for developing marketing campaigns. The number of people in different stages in the cycle can be obtained through a study of demographic data.

This cycle's stages include bachelor, newly married full nest (children at home), empty nest, and sole survivor. However, when using life cycle analysis, the growing numbers of people who do not follow the traditional pattern because they do not marry, do not have children, become divorced, belong to families with two working spouses (even if there are small children), and so, on, should be noted. The concept of the **household life cycle** which incorporates the life stages of both family and non family households is taking on greater significance.

### **Time Expenditures:**

Time expenditure reflect the work week, family care, and leisure.

Time expenditures refer to and involve the types of activities in which a person participates and the amount of time allocated to them. In recent decades, the average work week for an individual's primary job has declined by about five hours per week from roughly 40 hours per week to 35: but more people are working at to jobs. Two other trends are worth noting: urban Americans are spending significantly less time in family care, and leisure time activities are increasing substantially. Americans engage in watching television, driving for

pleasure, swimming, sight seeing, walking, bicycling, attending spectator events, and playing outdoor games and sports.

## **PSYCHOLOGICAL CHARACTERISTICS OF CONSUMERS**

### **A Personality:**

A personality describes a person's composite internal, enduring psychological traits. A personality is the sum total of an individual's enduring internal psychological traits that make the person unique. Self confidence, dominance, autonomy, sociability, defensiveness, adaptability, and emotional stability are selected personality traits. Personality has a strong impact on an individual's behaviour. For example a self confident and sociable person often will not purchase the same goods and services as an inhibited and aloof person. It is necessary to remember that a personality is made up of many traits operating in conjunction with one another.

### **Attitudes (opinions)**

Attitudes can be positive negative, or neutral. Attitudes (opinions) are an individual's positive, neutral, or negative feelings about goods, services, firms, people, issues, and /or institutions. Attitudes are shaped by demographics, social factors, and other psychological characteristics. One role of marketing is

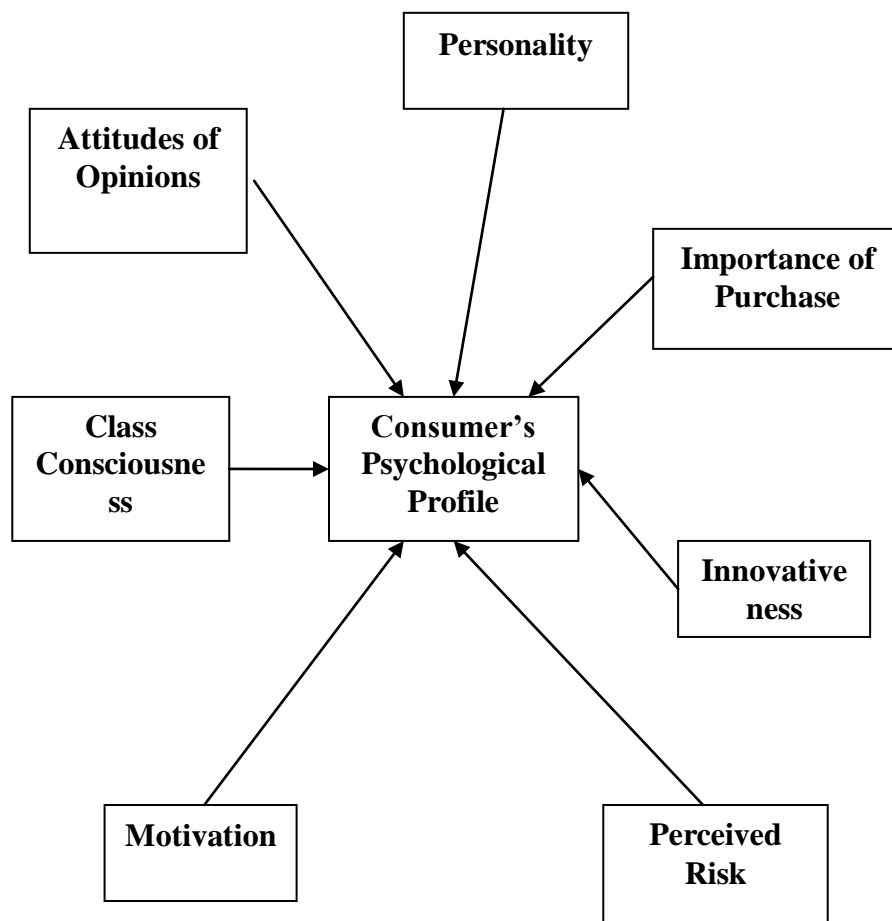


Fig 2.3 Consumer Psychological Profile

to generate favourable attitudes; given the intensive competition in many industries, a firm cannot normally succeed without positive consumer attitudes.

When studying attitudes, two concepts should often be measured; the attitude itself and the purchase intent toward a firm's brand.

**Class Consciousness:**

Class consciousness is low for inner directed persons and high for outer directed persons. Class consciousness is the extent to which social status is desired and pursued by a person. It helps determine an individual's interest in social class mobility, the use of reference groups, and the importance of prestige purchase. An inner directed person is interested in pleasing him or herself. He or she is generally attracted by products that perform well functionally, items that are challenging and can be used when the person is alone, and do it yourself products. An inner directed person is not concerned with social mobility, relies on his or her own judgement, and does not value prestige items. An **outer directed person** is interested in pleasing the people around him or her. Upward social mobility, approval by reference groups, and ownership of prestige items are sought. This person is generally attracted by products providing social visibility, well known brands and uniqueness. Functional performance may be less important.

#### **Motivation:**

Motivation is a drive impelling action: it is caused by motives. Motivation involves the positive or negative needs, goals, desires, and forces that impel an individual toward or away from certain actions, activities, objects, or conditions. By identifying and appealing to consumer's **motives**, the reasons for behaviour, a marketer can generate positive motivation.

Each person has distinct motives for buying and these change by situation and over time. Consumers often combine economic (price, durability) and emotional (status, self esteem) motives when making a purchase.

#### **Perceived risk:**

Perceived risk is the uncertainty felt by the consumers. Perceived risk is the level of uncertainty a consumer believes exists regarding the outcome of a purchase decision: this belief may or may not be correct. Perceived risk can be divided into six major types:

1. Functional – risk that a product will not perform adequately.

2. Physical – risk that a product will be harmful.
3. Financial – risk that a product will not be worth its cost.
4. Social – risk that a product will cause embarrassment before others.
5. Psychological – risk that one's ego will be bruised.
6. Time – risk that the time spent making a purchase will be wasted if the product does not perform as expected.

Companies must deal with perceive risk, even if consumers are incorrect in their beliefs, because a high level of perceived risk usually dampens customer motivation. Firms can reduce perceived risk by providing greater information, developing and maintaining a reputation for superior quality, offering money back guarantees, avoiding controversial ingredients, and so on.

**Innovativeness:**

Innovativeness is trying a new product others see as risky. A customer who is willing to try a new good or service perceived by others as having a high degree of risk is said to exhibit innovativeness. An innovator is likely to be younger and well educated, and to have an above average income for his or her social class. This person is also apt to be interested in change, achievement oriented, open-minded, status conscious, mobile and venture some. It is essential for marketers to identify and appeal to innovators when introducing a new good or service.

**Importance of Purchase:**

The importance of a purchase determine the time, effort, and money spent. The importance of a purchase affects the time and effort a consumer will spend shopping for a product as well as the amount of money allocated. An important purchase will involve careful decision making, high perceived risk, and probably a large amount of money. An unimportant purchase will receive little decision making time (the good or service may be avoided altogether) have little perceived risk, and probably are inexpensive.

**BUYING DECISION PROCESS:**

The consumer passes through five stages; problem recognition, information search, evaluation of alternatives, purchase decision, and post purchase behaviour. Clearly the buying process starts long before the actual purchase and has consequences long afterward.

The model figure 2.4 implies that consumers pass sequentially through all five stages in buying a product. But this is not the case; Consumers may skip or reverse some stages. A women buying her regular brand of toothpaste goes directly from the need for toothpaste to the purchase decision, skipping information search and evaluation. However, we will use the model figure 2.4 because it captures the full range of considerations that arise when a consumer faces a highly involving new purchase.

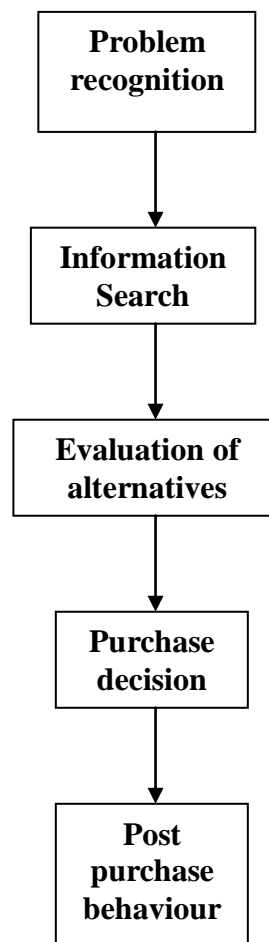


Fig 2.4 consumer Decision making process



## **PROBLEM RECOGNITION**

The buying process starts when the buyer recognized a problem or need. The need can be triggered by internal or external stimuli. In the former case, one of the person's normal needs hunger, thirst, sex rises to a threshold level and becomes a drive. In the latter case, a need is aroused by an external stimulus. A person passes a bakery and sees freshly baked bread that stimulates here hunger; she admires a neighbor's new car; or she watches a television ad for a Hawaiian vacation.

Marketers need to identify the circumstances that trigger a particular need. By gather in information from a number of consumers, marketers can identify they most frequent stimuli that spark an interest in a product category. They can then develop marketing strategies that trigger consumer interest.

## **INFOMRAITON SEARCH:**

An aroused consumer will be inclined to search for more information. We can distinguish between two levels of arousal. The milder search state is called *heightened attention*. At this level a person simply becomes more receptive to information about a product.

At the next level, the person may enter active information search; looking for reading material, phoning friends, and visiting stores to learn about the product. Of key interest to the marketer are the major information sources to which the consumer will turn and the relative influence each will have on the subsequent purchase decision. Consumer information sources fall into four groups.

- *Personal sources* : Family, friends, neighbours, acquaintances
- *Commercial Sources* : Advertising, salespersons, dealers, packaging, displays
- *Public sources* : Mass media, consumer rating organizations
- *Experiential sources* : Handling, examining, using the product.

The relative amount and influence of these information sources vary with the product category and the buyer's characteristics. Generally speaking, the consumer receives the most information about a product from commercial sources that is, marketer dominated sources. But the most effective information comes from personal sources. Each information source performs a different function in influencing the buying decision. Commercial information normally performs an informing function, and personal sources perform a legitimizing or evaluation function.

### **EVALUATION OF ALTERNATIVES**

Some basic concepts will help us understand consumers evaluation processes; First the consumer is trying to satisfy a need. Second, the consumer is looking for certain *benefits* from the product solution. Third, the consumer sees each product as a *bundle* of attributes with varying abilities of delivering the benefits sought to satisfy this need. The attributes of interest to buyers vary by product.

Consumers vary as to which product attributes they see as most relevant and the importance they attach to each attribute. They will pay the most attention to attributes that deliver the sought benefits. The market for a product can often be segmented according to attributes that are salient to different consumer groups.

The consumer develops a set of *brand beliefs* about where each brand stands on each attribute. The set of beliefs about a brand make up the *brand image*. The consumer's brand image will vary with his or her experiences as filtered by the effects of selective perception, selective distortion, and selective retention.

The consumer arrives at attitudes (judgements, preferences) toward the various brands through an attribute evaluation procedure.

## **PURCHASE DECISION**

In the evaluation stage, the consumer forms preferences among the brands in the choice set. The consumer may also form an intention to buy the most preferred brand. However, two factors can intervene between the purchase intention and the purchase decision.

The first factor is the *attitudes of others*. The extent to which another person's attitude reduces one's preferred alternative depends on two things :

1. the intensity of the other person's negative attitude toward the consumer's preferred alternative and
2. the consumer's motivation to comply with the other person's wishes.

The more intense the other person's negativism and the closer the other person is to the consumer, the more the consumer will adjust this or her purchase intention.

The second factor is *unanticipated situational factors* that may erupt to change the purchase intention. Jack Hamilton might lose his job, some other purchase might become more urgent, or a store salesperson may turn him off. Preferences and even purchase intentions are not completely reliable predictors of purchase behaviour.

In executing a purchase intention, the consumer may make up to five purchase sub decisions; a brand decision (brand A) vendor decision (dealer 2) quantity decision (one computer) timing decision (weekend) and payment method decision (credit card). Purchases of every day products involve fewer decision and less deliberation.

## **POST PURCHASE BEHAVIOUR:**

After purchasing the product, the consumer will experience some level of satisfaction or dissatisfaction. The marketer's job does not end when the product is bought. Marketers must monitor post purchase satisfaction, post purchase actions, and post purchase product uses.

## **POST PURCHASE SATISFACTION**

What determines whether the buyer will be highly satisfied, somewhat satisfied, or dissatisfied with a purchase? The buyer's satisfaction is a function of the closeness between the buyer's expectations and the product's perceived performance. If performance falls short of expectations, the customer is disappointed; if it meets expectations, the customer is satisfied; if it exceeds expectations, the customer is delighted. These feelings make a difference in whether the customer buys the product again and talks favourably or unfavourably about the product to others.

## **POST PURCHASE ACTIONS**

The consumer's satisfaction or dissatisfaction with the product will influence subsequent behaviour. If the consumer is satisfied, he or she will exhibit a higher probability of purchasing the product again.

Dissatisfied consumers may abandon or return the product. They may seek information that confirms its high value. They may take public action by complaining to the company, going to a lawyer, or complaining to other groups (such as business, private, or government agencies). Private actions include making a decision to stop buying the product (exit option) or warning friends (voice option). In all these cases, the seller has done a poor job of satisfying the customer.

## **Post purchase Use and Disposal**

Marketers should also monitor how buyers use and dispose of the product. If consumers store the product in a closet, the product is probably not very satisfying, and word of mouth will not be strong. If they sell or trade the product, new product sales will be depressed. Consumers may also find new uses for the product: If consumers throw the product away, the marketer needs to know how they dispose of it, especially if it can hurt the environment.

## **SERVICE QUALITY – GAP MODEL AND QUALITY DIMENSIONS**

Service firms like other organizations are realizing the significance of customer-centered philosophies and are turning to quality management approaches to help managing their businesses. The topic has started with the concept of service quality and has demonstrated the model of service quality gaps. SERVQUAL as an effective approach has been studied and its role in the analysis of the difference between customer expectations and perceptions has been highlighted with support of an example, Outcomes of the study outline the fact that although SERVQUAL could close one of the important service quality gaps associated with external customer services, it could be extended to close other major gaps and therefore, it could be developed in order to be applied for internal customers, i.e. employees and service providers.

Managers in the service sector are under increasing pressure to demonstrate that their services are customer-focused and that continuous performance improvement is being delivered. Given the financial and resource constraints under which service organisations must manage it is essential that customer expectations are properly understood and measured and that, from the customers perspective, any gaps in service quality are identified. This information then assists a manager in identifying cost-effective ways of closing service quality gaps and of prioritizing which gaps to focus on – a critical decision given scarce resources.

While there have been efforts to study service quality, there has been no general agreement on the measurement of the concept. The majority of the work to date has attempted to use the SERVQUAL (Parasuraman *et al.*, 1985; 1988) methodology in an effort to measure service quality.

One of the aims of this topic involves the use of SERVQUAL instrument in order to ascertain any actual or perceived gaps between customer expectations and perceptions of the service offered. Another aim of this topic is to point out how management of service improvement can become more logical and

integrated with respect to the prioritized service quality dimensions and their affections on increasing/decreasing service quality gaps. In the following, after a brief review of the service quality concept, the model of service quality gaps and the SERVQUAL methodology is demonstrated and an example is presented to pinpoint the application of the SERVQUAL approach. Then, after a discussion, major conclusions are derived.

### **Service Quality**

Service quality is a concept that has aroused considerable interest and debate in the research literature because of the difficulties in both defining it and measuring it with no overall consensus emerging on either (Wisniewski, 2001). There are a number of different "definitions" as to what is meant by service quality. One that is commonly used defines service quality as the extent to which a service meets customers' needs or expectations (Lewis and Mitchell, 1990; Dotchin and Oakland, 1994a; Asubonteng *et al.*, 1996; Wisniewski and Donnelly, 1996). Service quality can thus be defined as the difference between customer expectations of service and perceived service. If expectations are greater than performance, then perceived quality is less than satisfactory and hence customer dissatisfaction occurs (Parasuraman *et al.*, 1985; Lewis and Mitchell, 1990).

Always there exists an important question: why should service quality be measured? Measurement allows for comparison before and after changes, for the location of quality related problems and for the establishment of clear standards for service delivery. Edvardsen *et al.* (1994) state that, in their experience, the starting point in developing quality in services is analysis and measurement. The SERVQUAL approach is the most common method for measuring service quality.

### **Model of Service Quality Gaps**

There are seven major gaps in the service quality concept, which are shown in Figure 1. The model is an extension of Parasuraman *et al.* (1985).

According to the following explanation (ASI Quality Systems, 1992; Curry, 1999; Luk and Layton, 2002), the three important gaps, which are more associated with the external customers are Gap1, Gap5 and Gap6; since they have a direct relationship with customers.

- **Gap1: Customers' expectations versus management perceptions:** as a result of the lack of a marketing research orientation, inadequate upward communication and too many layers of management.

- **Gap2: Management perceptions versus service specifications:** as a result of inadequate commitment to service quality, a perception of unfeasibility, inadequate task standardisation and an absence of goal setting.

- **Gap3: Service specifications versus service delivery:** as a result of role ambiguity and conflict, poor employee-job fit and poor technology-job fit, inappropriate supervisory control systems, lack of perceived control and lack of teamwork.

- **Gap4: Service delivery versus external communication:** as a result of inadequate horizontal communications and propensity to over-promise.

- **Gap5: The discrepancy between customer expectations and their perceptions of the service**

**delivered:** as a result of the influences exerted from the customer side and the shortfalls (gaps) on the part of the service provider. In this case, customer expectations are influenced by the extent of personal needs, word of mouth recommendation and past service experiences.

- **Gap6: The discrepancy between customer expectations and employees' perceptions:** as a result of the differences in the understanding of customer expectations by front-line service providers.

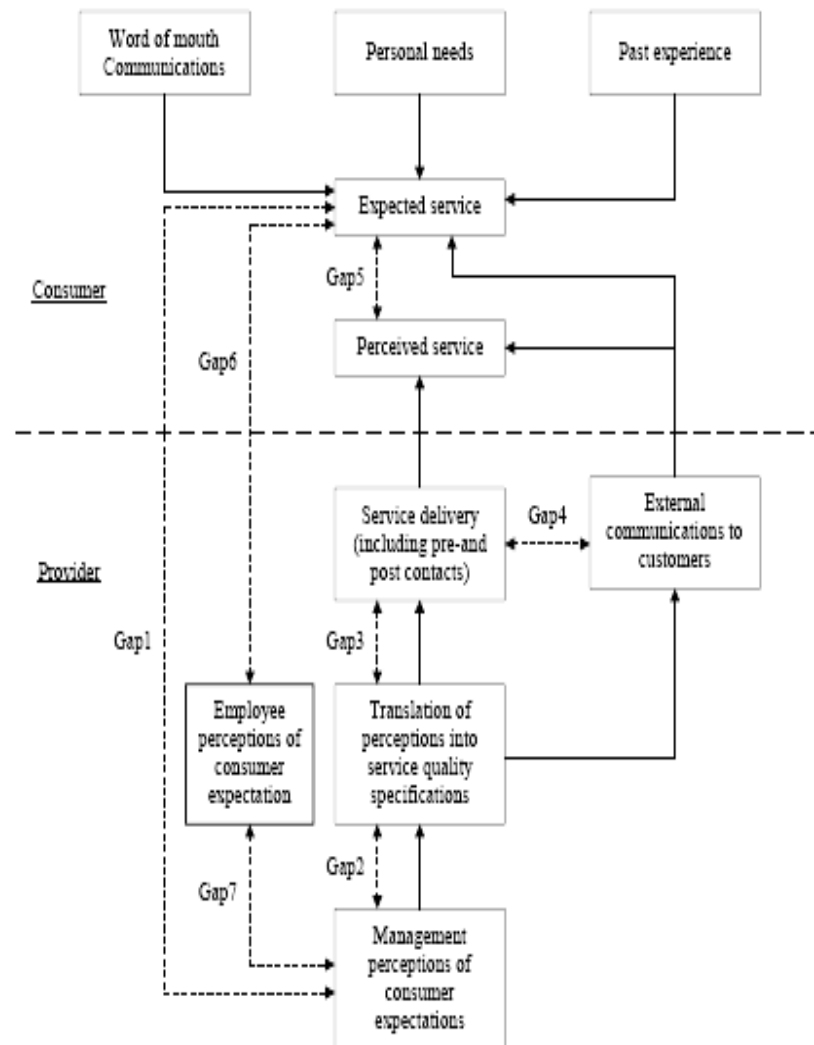


Figure 1. Model of service quality gaps (Parasuraman et al., 1985; Curry, 1999; Luk and Layton, 2002)

· **Gap7: The discrepancy between employee's perceptions and management perceptions:** as a result of the differences in the understanding of customer expectations between managers and service providers. **Figure 1. Model of service quality gaps** (Parasuraman et al., 1985; Curry, 1999; Luk and Layton, 2002) According to Brown and Bond (1995), "the gap model is one of the best received and most heuristically valuable contributions to the services literature". The model identifies seven key discrepancies or gaps relating to managerial perceptions of service quality, and tasks associated with service delivery to customers. The first six gaps (Gap 1, Gap 2, Gap 3, Gap 4, Gap 6 and Gap 7) are identified as functions of the way in which service is delivered, whereas Gap 5 pertains to the customer and as such is considered to be the true measure of service quality. The Gap on which the SERVQUAL methodology has influence is Gap 5. In the following, the SERVQUAL approach is demonstrated.



### **SERVQUAL methodology**

Clearly, from a Best Value perspective the measurement of service quality in the service sector should take into account customer expectations of service as well as perceptions of service. However, as Robinson (1999) concludes: "It is apparent that there is little consensus of opinion and much disagreement about how to measure service quality". One service quality measurement model that has been extensively applied is the SERVQUAL model developed by Parasuraman. SERVQUAL as the most often used approach for measuring service quality has been to compare customers' expectations before a service encounter and their perceptions of the actual service delivered (Gronroos, 1982; Lewis and Booms, 1983; Parasuraman *et al.*, 1985). The SERVQUAL instrument has been the predominant method used to measure consumers' perceptions of service quality. It has five generic dimensions or factors and are stated as follows (van Iwaarden *et al.*, 2003):

- (1) *Tangibles*. Physical facilities, equipment and appearance of personnel.
- (2) *Reliability*. Ability to perform the promised service dependably and accurately.
- (3) *Responsiveness*. Willingness to help customers and provide prompt service.
- (4) *Assurance* (including competence, courtesy, credibility and security). Knowledge and courtesy of employees and their ability to inspire trust and confidence.
- (5) *Empathy* (including access, communication, understanding the customer). Caring and individualized attention that the firm provides to its customers.

In the SERVQUAL instrument, 22 statements measure the performance across these five dimensions, using a seven point likert scale measuring both customer expectations and perceptions (Gabbie and O'Neill, 1996). It is important to note that without adequate information on both the quality of

services expected and perceptions of services received then feedback from customer surveys can be highly misleading from both a policy and an operational perspective. In the following, the application of SERVQUAL approach is more specified with an example in a catering company.

### **Example**

In an investigation conducted by Bryslan and Curry (2001) in a catering company, a total of 140 questionnaires were distributed to all of the previous year's customers and 52 useable questionnaires were returned, resulting in a 37 per cent response rate. As can be seen from Table I, all questionnaire responses were negative and an overall departmental weighted SERVQUAL score of  $-1.6$  was recorded, indicating a significant shortfall in meeting customer expectations across all service areas and dimensions. The summary scores for each dimension are shown in Table I, with the weighted average scores per dimension having been totalled to achieve the overall SERVQUAL score. As can be seen from Table I, the highest gap scores were for Reliability and Responsiveness; this is real cause for concern and provides a definite starting point for service improvements. As can be seen from the results, the customer expects most from the Reliability dimension of the catering service. The relatively low importance of Tangibles could be attributable to the fact that customers are aware of the financial constraints which are typical in the local authority funding context, and simply do not expect much when it comes to aesthetics; instead, they attach more importance to the delivery aspects of the service. Customers allocated to Assurance the lowest weighting, indicating it to be of least importance to them, yet they expect most from this service dimension. This apparent anomaly is probably due to the fact that customers expect staff to be knowledgeable about the service and therefore they can see no reason for this dimension not to be achieved. It is assumed that for this reason, customers have weighted this dimension lowest.

Table I. SERVQUAL scores for catering services (Bryslan and Curry, 2001)

Dimension	Expectations	Perceptions	Gap scores	Weightings	Weighted average
Tangibles	5.66	4.26	-1.40	19.8	-0.28
Reliability	6.06	4.36	-1.70	29.6	-0.5
Responsiveness	5.74	4.05	-1.69	19.9	-0.34
Assurance	6.13	4.58	-1.55	15.2	-0.24
Empathy	5.97	4.45	-1.52	15.7	-0.24

Note: Overall average weighted SERVQUAL score = -1.6

## Discussion

The research on measuring service quality has focused primarily on how to meet or exceed the external customer's expectations, and has viewed service quality as a measure of how the delivered service level matches consumer's expectations. These perspectives can also be applied to the employees of a firm and in this case, other major gaps could be closed in the service quality gaps model (Kang *et al.*, 2002).

The concept of measuring the difference between expectations and perceptions in the form of the SERVQUAL gap score proved very useful for assessing levels of service quality. Parasuraman *et al.*, argue that, with minor modification, SERVQUAL can be adapted to any service organisation. They further argue that information on service quality gaps can help managers diagnose where performance improvement can best be targeted. The largest negative gaps, combined with assessment of where expectations are highest, facilitates prioritisation of performance improvement. Equally, if gap scores in some aspects of service do turn out to be positive, implying expectations are actually not just being met but exceeded, then this allows managers to review whether they may be "over-supplying" this particular feature of the service and whether there is potential for re-deployment of resources into features which are underperforming.

It seems that in almost all the existing resources, the SERVQUAL approach has been used only for closing Gap 5. However, its application could also be extended to the analysis of other gaps. It is important to note that SERVQUAL is only one of the instruments used in service quality analysis and there are different approaches which might be stronger in closing gaps. SERVQUAL has been extensively criticised on both theoretical and operational grounds (see Buttle, 1996 and Asubonteng *et al.*, 1996), although Asubonteng *et al.* (1996) conclude that: "Until a better but equally simple model emerges, SERVQUAL will predominate as a service quality measure". It is also evident that SERVQUAL by itself, useful though it may be to a service manager, will not give a complete picture of needs, expectations and perceptions in a service organization context. As Gaster (1995) comments, "because service provision is complex, it is not simply a matter of meeting expressed needs, but of finding out unexpressed needs, setting priorities, allocating resources and publicly justifying and accounting for what has been done". Service organizations are responsible and accountable to citizens and communities as well as to customers and service users. There are wider service organization agendas than simply service quality: improving access to existing services; equity and equality of service provision; providing efficient and effective services within political as well as resource constraints. The definition of service quality therefore takes on a wider meaning and accordingly its measurement becomes both more complex and more difficult.

Besides the discussed weaknesses, a particular advantage of SERVQUAL is that it is a tried and tested instrument which can be used comparatively for benchmarking purposes (Bryceland and Curry, 2001). SERVQUAL does, however, benefit from being a statistically valid instrument as a result of extensive field testing and refinement. It therefore escapes the pitfall of being perceived by service users and providers as "something that has been invented off the top of the head" or a questionnaire that has been skewed to

elicit certain types of response. As a generic and universally-applicable instrument, SERVQUAL can also be administered on a repeated, regular basis and used for comparative benchmarking purposes. To appreciate more fully the benefits of using SERVQUAL, surveys should be conducted every year, for the following reasons:

- to allow yearly comparisons;
- to determine how service improvements have affected customers' perceptions and expectations of the service over time; and
- to determine the effectiveness of service development and improvement initiatives in targeted dimensions.

It is important to note that the measurement systems themselves are often inappropriate because the system designers do not know enough about what is to be measured. Measuring customer perceptions of service may increase expectations and measuring too often may well result in customers losing their motivation to answer correctly. Finally, there is no point in measuring service quality if one is not willing to take appropriate action on the findings.

Service quality and its model of gaps were reviewed. SERVQUAL methodology as an analytical approach for evaluating the difference between customers' expectations and perceptions of quality was also studied.

While this research provides some perspectives to the field of service quality, it is believed that there are a number of things that should be done to confirm the demonstrated methodologies as well as to expand the use of SERVQUAL in design and improvement of quality services.

Just as the SERVQUAL instrument is extensively used to assess external service quality, the instrument can also be modified to assess the quality of the internal service provided by departments and divisions within a company to employees in other departments and divisions. The results of the current study illustrate that organizations can at least assess five dimensions of service quality to ascertain the level of services provided, and to determine which dimensions need improvement.

In order to improve service quality, it is necessary to contact employees regularly and assess their service experiences. Like the external customer, an internal customer too considers categories of service attributes, such as reliability and responsiveness, in judging the quality of the internal service. With the knowledge of the internal service quality dimensions, the service organizations can then judge how well the organization or employees performed on each dimension and managers could identify the weakness in order to make improvements.

Future research should seek to examine the use of SERVQUAL to close other service quality gaps for different types of organizations. Also, an important issue for future research is about the relationship between internal service quality and external customer satisfaction as well as other constructs, such as employee service orientation, and external service quality.

In conclusion, knowing how customers perceive the service quality and being able to measure service quality can benefit industry professionals in quantitative and qualitative ways. The measurement of service quality can provide specific data that can be used in quality management; hence, service organizations would be able to monitor and maintain quality service. Assessing service quality and better understanding how various dimensions affect overall service quality would enable organizations to efficiently design the service delivery process. By identifying strengths and weaknesses pertaining to the dimensions of service quality organizations can better allocate resources to provide better service and ultimately better service to external customers.

#### Questions for discussion

1. Explain the environment of marketing in which marketing operates.
2. How does a firm's corporate culture influence the performance of its marketing personnel?
3. How does social class affect an individual's life-style and purchase ?
4. Why demographic data alone frequently insufficient for marketing decisions?
5. Explain the consumer decision making process.
6. Explain SERVQUAL model.

## **Unit – III**

### **Marketing Mix**

Marketing is a process of perceiving, understanding, stimulating and satisfying the needs of specially selected target markets by channelling an organization's resources to meet those needs. Marketing is thus a process of matching an organizations resource to the needs of the market.

Marketing mix is the important internal elements or ingredients that make up an organization's marketing programme. The marketing mix is one of the most universal concepts which has been developed in marketing.

The marketing mix concept is well-established tool used as a structure by marketers. It consists of the various elements of a marketing programme, which need to be considered in order to successfully implement the marketing strategy and positioning in the company's markets. The discipline of considering the integration of the elements of the marketing mix, as well as individual various elements, helps ensure that there is consistency within the marketing strategy as a whole.

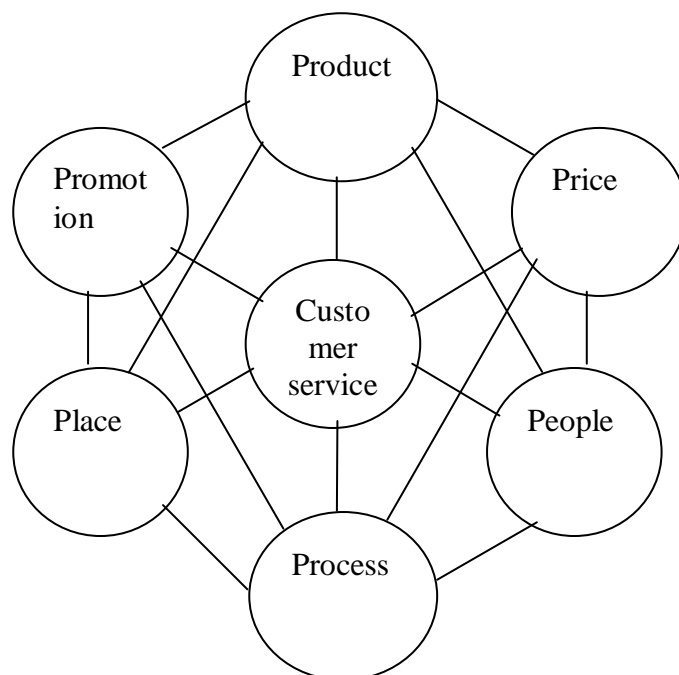
Traditionally, most marketers have considered four basic components or elements of a marketing mix: product, price, promotion and place. However, within services marketing, it is useful to extend this list to include other key ingredients. A consideration of each element of the marketing mix and how they fit together forms the basis of a marketing programme.

Essentially the marketing mix represents the factors, which need to be considered when determining a service firm's marketing strategy. The starting



point for making any decisions about marketing mix depends both on how the service is to be positioned and the market segments to be addressed. The advantage of using a marketing mix framework is that it permits the fit between the various elements to be considered. Each element within the marketing mix has an impact on all the other elements.

Figure 3.1 Expanded marketing mix for services



## Product

A product is anything that satisfies a need or want and can be offered in an exchange. A product can be a good, service, idea, or combination of all three. A services is intangible yet provides direct benefits to consumers. The product is a key variable in the marketing mix - promotion, distribution and price decisions must be coordinated with product decisions. If a company's products do not meet the desires and needs of its customers, the company will fail. By identifying consumer needs and wants and developing products that satisfy them, company are more likely to succeed.

Services cannot be defined in terms of their physical attributes because they are intangible. It is often difficult, then, for consumers to understand

service offerings and to evaluate possible service alternatives. Tangible elements-facilities, employees, communications-associated with a service help to form the product and are often the only features of a service that can be viewed or evaluated prior to purchase. That is way marketers should pay close attention to these tangible elements and ensure that they are consistent with the selected image of the service product. Marketers should also focus on the benefits the customer is buying rather than on the service itself.

Consumers often equate service products with the provider of the service. This is especially true for labour-based services. Consider a bank, for instance. Money a tangible good of the bank, is an undifferentiated product-it is the same at all banks. But a teller – who may be competent and accommodating or slow and irritable-is the service provided by the bank. Because service personnel like tellers are perceived as the service and because they are inconsistent in their behaviour, it is essential that marketers carefully select, train, motivate, and control these contact people. Service providers are selling long-term relationships as well as providing a service.

Selecting a name for a service organization can be critical because, in services, the company name is the service. A well chosen name can give a company a decided marketing edge over competitors by providing strong brand identity. Good service names should be distinctive relevant, memorable, and flexible.

## **Price**

Price is the “Something of value” in an exchange. Consumer exchange something value. Price places a value on a good service. Many words are substitutes for the term price including admission fee, membership fee, rate, tuition, service charge, donation, rent, salary, interest, premium, fare, dues. Price is probably the most flexible element of marketing mix. Organisation can

adjust prices much more easily than they can modify the product, change the promotional program, a redesign the distribution system. Price is also the only marketing mix variable that relates directly to revenue. Price also has a psychological impact on customers.

The intangible nature of services makes establishing prices difficult. The price of physical goods can be based on the cost of production (materials, labour, and over head). However, determining the cost of producing service for the purpose of setting a price is more complicated. Because of the intangible nature of services, price may function as an important cue to consumers. When services-particularly labour based services-are equivalent, price may important in selecting a service provider.

A consumer seeking help with financial planning, for example, may believe that a financial counsellor who charges more than others is more qualified and, thus, may choose the adviser with the highest fee. Marketing two or more services together as a single package for a special price is a practice called bundling. The use of bundling to simulate demand for services has been expanding in recent years.

Likewise, banks offer special programs in which customers receive credit cards travellers checks, and other financial services. Pricing can also be used to smooth fluctuations in demand for services. A service provider may lower prices to help stimulate demand during slow periods and raise prices during peak periods to discourage demand.

## **Place**

It refers to distribution. It is a marketing activities that makes product available to consumers at the right time and in convenient location. The location and channels used to supply services to target customers are two key decision areas. The location and channel decisions involve considering how to deliver the service to the customer and where this should take place. Service marketers

should seek to develop appropriate service delivery approaches that yield competitive advantage for their firms.

Most services are limited to direct channels of distribution because of the inseparability of production and consumption. However, some types of services to make use of marketing intermediaries. Automatic teller machines(ATMs) serve as electronic intermediaries for financial services. Master Card and VISA credit cards have enabled banks to extend their credit services to consumers in widely dispersed geographic areas.

The distribution of services is closely linked to product development. To provide tangibility, a marketer may develop a physical symbol of the service. If a physical symbol can be created, then the service can be separated from the provider, suggesting that direct sale is not the only distribution alternative. For instance, bank credit cards, which are physical symbols of credit, enable retailers to act as indirect intermediaries in the distribution of an intangible service-credit. Additionally, extending a line of credit to a consumer allows him or her to store the intangible service of credit.

### **Promotion**

Promotion refers to marketing activities used to communicate to target positive, persuasive information about an organization, its products and activities to directly or indirectly expedite exchanges. The promotion elements play a vital role in helping communicate the positioning of the services to customers and other of the key relationship markets. The promotion of services include the following elements, advertising, personal selling, sales promotion, public relation, word of mouth and direct mail.

Because services are intangible-dominant products, they are difficult to advertise. Something intangible is not easily depicted in advertising, whether the medium is print, television, or radio. Therefore, advertising of services should

emphasize tangible cues, or symbols, of the services that are more easily perceived and understood by consumers.

Advertising can also be used to facilitate internal marketing. A service provider's employees are an important secondary audience for services advertising.

Personal selling can play a powerful role in promoting services because it enables consumers and sales people to interact. If properly trained, sales people can use this interaction to reduce consumer uncertainty, give reassurance, reduce dissonance, and promote the reputation of the organization. Once again, careful training and management of customer contact personnel is crucial to the success of service provider.

Sales promotions are more difficult to implement for services than for goods. Promotion methods such as point-of-purchase displays and free samples are generally impossible to use. Intangible products like health care and accounting services cannot be displayed, and if free samples are used, the firm has to give away the entire product. Coupons, rebates, contests, and free first-time visits to the service facilities are feasible sales promotion tools for some service firms.

Finally, service firms usually rely more heavily on publicity than do firms marketing goods. This is especially true of non-profit organizations, which cannot afford extensive advertising. Another reason that service firms rely on publicity is because it is viewed as being more objective than advertising.

### **People in services**

The success of marketing a service is tied closely to the selection, training, motivation and management of people. There are many examples of services failing or succeeding as a consequence of the ineffective or effective management of people.

The importance of people within the marketing of services has led to great interest in internal marketing. This recognizes the importance of attracting, motivating, training, and retaining quality employees by developing jobs to satisfy individual needs. Internal marketing aims to encourage effective behaviour by staff which will attract to work in those companies which are seen to be good employers.

Attempts to view the employees of an organization as an element of a service organization's marketing mix have been notably absent from academic marketing literature until recently. While the expression our employees are our greatest asset is increasingly being heard among companies, it is clear that this statement is often a platitude. By recognizing the contribution people make to acquiring and keeping customers within the overall marketing mix, the service company's competitive performance will be substantially enhanced.

### **Differing roles of people**

An essential aspect of viewing people as an element of the marketing mix is to recognize the different roles in which people affect both the marketing task and customer contact. Judd has developed a categorization scheme based on the degree of frequency of customer contact and the extent to which staff are involved with conventional marketing activities. This categorization results in four groups : contractors, modifiers, influencers and isolateds

- Contactors have frequent or regular customer contact and are typically heavily involved with conventional marketing activities. They hold a range of positions in service firms including selling and customer service roles. Whether they are involved in planning or execution of marketing strategy they need to be well versed in the marketing strategies of the firm. They should be well trained, prepared and motivated to serve the customers on a day – to- day basis in a responsive manner. They should

be recruited based on their potential to be responsive to customer needs and be evaluated and rewarded on this basis.

- Modifiers are people such as receptionists, credit department and switchboard personnel; while they are not directly involved with conventional marketing activities to a great degree, they nevertheless have frequent customer contact. As such they need to have a clear view of the organization's marketing strategy and the role that they can play in being responsive to customers' needs. They have a vital role to play especially, but not exclusively, in service businesses. Modifiers need to develop high levels of customer relationship skills. Training and monitoring of performance are especially important here.
- Influencers, while involved with the traditional elements of the marketing mix, have infrequent or no customer contact. However, they are very much part of the implementation of the organization's marketing strategy. They include those with roles in product development, market research, etc. In requirement of influencers people with the potential to develop a sense of customer responsiveness should be pursued. Influencers should be evaluated and rewarded according to customer-oriented performance standards and opportunities to enhance the level of customer contact should be programmed into their activities.
- Isolates perform various support functions and have neither frequent customer contact nor a great deal to do with the conventional marketing activities. However, as support people their activities critically affect performance of the organization's activities. Staff falling within this category include purchasing department, personnel and data processing. Such staff need to be sensitive to the fact that internal customers as well as external customers have needs which must be satisfied. They need to understand the company's overall marketing strategy and how their functions contribute to the quality of delivered value to the customer.

This suggests that people form an important part of the differentiation in a service organization which can create added value for the customer. By viewing people as a separate element of the marketing mix, the appropriate level of attention can be directed to maximizing the impact of their activities and motivating and rewarding them to make the desired contribution.

### **Process**

The processes by which services are created and delivered to the customer is a major factor within the services marketing mix as services customers will often perceive the service delivery system as part of the service itself. Thus decisions on operations management are of great importance to the success of the marketing of the service. In fact, continuous coordination between marketing and operations is essential to success in most service business.

All work activity is process. Processes involve the procedures, tasks schedules, mechanisms, activities and routines by which a product or service is delivered to the customer. It involves policy decisions about customer involvement and employee discretion. Identification of process management as a separate activity is a prerequisite of service quality improvement. The importance of this element is especially highlighted in service business where inventories cannot be stored. Banks provide a good example of this. By reconfiguring the way they deliver service through the introduction of automatic teller machines (ATMs) Banks have been able to free staff to handle more complex customer needs by diverting cash only customers to the ATMs.

This suggests that close cooperation is needed between the marketing and operations staff who are involved in process management. By identifying processes as a separate marketing mix element, we recognize its importance to service quality.



The immediacy of production of services can be used to advantage in the tailoring of the services product to meet customer needs.

Decision-making processes are also of relevance. Some service providers give their service deliverers the autonomy to make decisions. For example, the billing of legal services is largely within the hands of the principal working on the case. A law firm will have charge out rates for individuals within the firm but these will vary according to the real and perceived complexity of the case where value based billing is used.

It can be seen from the above examples that processes of delivery and decision making are of great significance for the successful marketing of a service.

The choice of process can therefore be a source of competitive advantage for a services company.

In reviewing the role of processes two issues are worthy of particular attention: how process can be seen as structural elements that can be altered to help achieve positioning strategy; and how marketing and operations should be managed to achieve synergy between them.

Processes can be considered in two ways: in terms of complexity and in terms of divergence. Complexity is concerned with the nature of the steps and sequences that constitute the process, while divergence refers to the executional latitude or variability of the steps and sequences.

Services processes can be analysed according to their complexity and divergence. Thus the keeping of account books for a corner shop is relatively low in divergence and complexity, hotel services may be low in divergence but in high complexity, and a general surgeon's work is high in both complexity and divergence.

Process can be changed in terms of complexity and divergence to reinforce the positioning or establish a new positioning. The four options are as follows:

- Reduced divergence. This tends to reduce costs, improve productivity and make distribution easier. It can also produce more uniform service quality and improved service availability. However, negative effects may include a perception of limited choice and a rejection of the highly standardized service.
- Increased divergence. This involves greater customisation and flexibility which may command higher prices. This approach suggests a niche positioning strategy based less on volume and more on margins.
- Reduced complexity. This usually means a specialization strategy. Steps and activities are omitted from the service process and this tends to make distribution and control easier.
- Increased complexity. Greater complexity is usually a strategy to gain higher levels of penetration in a market by adding more services. supermarkets, banks and building societies tend to follow this approach.

### **Customer service**

A major differentiating factor for services companies is the quality of customer service. Customers are becoming more sophisticated in their requirements and are increasingly demanding higher standards of service. Many major services companies have woken up to the need to improve customer service in order to compete in today's highly competitive service environment.

In the marketing literature customer service is often seen to be part of the 'place' marketing mix element and to be concerned with the distribution and logistics component of that element. This view of customer service as the outcome of the distribution and logistics functions seeks to explain its significance in terms of the way in which services are delivered and the extent to which customers are satisfied, especially in the context of reliability and speed of delivery.

We consider, however, that several arguments support the choice of customer service as a broader and separate element of the marketing mix. These include the following:

- Changing customer expectations. In almost every market the customer is now more demanding and more sophisticated than he or she was, say, thirty years ago.
- The increased importance of customer service. With changing customer expectations, competitors are seeing customer service as a competitive weapon with which to differentiate their sales. The issue and importance of customer service has been commented on by many writers.
- The need for a relationship strategy. To ensure that a customer service strategy that will create a value proposition for customers is formulated, implemented and controlled it is necessary to give it a central role and not one that is subsumed in the various elements of the marketing mix.

### **A wider view of customer service**

Companies often have different perspectives on customer service. Studies have shown that a range of views exists as to the definition of customer service. These include, in a service context:

- All the activities required to accept, process, deliver and fulfil customer orders and to follow up on any activity that has gone wrong.
- Timeliness and reliability of delivering products and services to customers in accordance with their expectations.
- A complex of activities involving all areas of the business which combine to deliver the company's products and services in a fashion that is perceived as satisfactory by the customer and which advances the company's objectives.

- Total order entry and all communications with customers, all invoicing and total control of defects.
- Timely and accurate delivery of products and services ordered by customers with accurate follow up and enquiry response including timely delivery of invoice.

### **Developing a marketing mix strategy**

We have now considered seven elements of the services marketing mix. Each of these marketing mix elements interact with each other and they should be developed so that they are mutually supportive in obtaining the best possible match between the internal and external environments of the organization. In developing a marketing mix strategy service marketers need to consider the relationships between the elements of the mix.

It has been pointed out that there are three degrees of interaction between the marketing mix elements.

- **Consistency**, where there is a logical and useful fit between two or more elements of the marketing mix .
- **Integration**, which involves an active harmonious interaction between the elements of the mix.
- **Leverage**, which involves a more sophisticated approach and is concerned with using each element to best advantage in support of the total marketing mix.

Thus effective relationship marketing is based on the choice and design of marketing mix elements that are mutually supportive and leveraged together so that synergy is achieved. This implies that people, processes and customer service should be seen as crucial additional elements of services marketing mix.

Each of the elements of the marketing mix and their sub elements need to focus on supporting each other in terms of consistency, integration and leverage, reinforcing the positioning and delivery of the service quality required by the market segment (or segments) that are targeted.

In developing a marketing mix strategy we need to consider the impact of each marketing mix element on the market segments selected. This implies ensuring that there is:

- A fit between the marketing mix and each target segment.
- A fit between the marketing mix and the company's strategic capabilities, emphasizing its strengths and minimizing the impact of its weaknesses.
- A recognition of competitors' capabilities, which involves evading their strengths and capitalizing on their weaknesses.

To achieve this an effective marketing plan should outline how the marketing mix strategy is to be developed and implemented. This involves organizing marketing resources, deciding levels of marketing expenditure and determining the expected results.

## **NEW FINANCIAL PRODUCTS AND SERVICES**

Today the importance of financial services is gaining momentum all over the world. In these days of complex finance, people expect a Financial Service Company to play a very dynamic role not only as a provider of finance but also as a departmental store of finance. With the injection of the economic liberalisation policy into our economy and opening of the economy to multinationals, the free market concept has assumed much significance. As a result, the clients both corporates and individuals are exposed to the phenomena of volatility and uncertainty and hence they expect the financial service company to innovate new products and services so as to meet their varied requirements.

Many financial intermediaries including banks have already started expanding their activities in the financial services sector by offering a variety of new products. As a result, sophistication and innovations have appeared in the arena of financial intermediations. Some of them are briefly discussed below:

**(i) Merchant banking :** Merchant banking may be defined as, ‘an institution which covers a wide range of activities such as management of customer services, portfolio management, credit syndication, acceptance credit, counselling, insurance etc.

The Notification of the Ministry of Finance defines a merchant banker as, “ any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management.

A merchant banker is a financial intermediary who helps to transfer capital from those who possess it to those who need it. Merchant banking includes a wide range of activities such as management of customers securities, portfolio management, project counselling and appraisal, underwriting of shares and debentures, loan syndication, acting as banker for the refund orders, handling interest and dividend warrants etc. Thus, a merchant banker renders a host of services to corporate and thus promotes industrial development in the country.

**(ii) Loan Syndication :** This is more or less similar to ‘consortium financing’. But, this work is taken up by the merchant banker as a lead-manager. It refers to a loan arranged by a bank called lead manager for a borrower who is usually a large corporate customer or a Government Department. The other banks who are willing to lend can participate in the loan by contributing an amount suitable to their own lending policies. Since a single bank cannot provide such a huge sum as loan, a number of banks join together and form a syndicate. It also enables

the members of the syndicate to share the credit risk associated with a particular loan among themselves.

**(iii) Leasing :** Leasing, as financing concept, is an arrangement between two parties, the leasing company or lessor and the user or lessee, whereby the former arranges to buy capital equipment for the use of the latter for an agreed period of time in return for the payment of rent. The rentals are predetermined and payable at fixed intervals of time, according to the mutual convenience of both the parties. However, the lessor remains the owner of the equipment over the primary period.

A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called 'rental charges'. The lessee cannot acquire any ownership to the asset, but he can use it and have full control over it. He is expected to pay for all maintenance charges and repairing and operating costs. In countries like the U.S.A., the U.K and Japan equipment leasing is very popular and nearly 25% of plant and equipment is being financed by leasing companies. In India also, many financial companies have started equipment leasing business. Commercial banks have also been permitted to carry on this business by forming subsidiary companies.

**(iv) Mutual Funds:**

A mutual fund collects the savings from small investors, invest them in Government and other corporate securities and earn income through interest and dividend, besides capital gains. It works on the principle of 'small drops of water make a big ocean'.

A mutual fund is nothing but a form of collective investment. It is formed by the coming together of a number of investors who transfer their surplus funds to a professionally qualified organisation to manage it.

A mutual fund refers to a fund raised by a financial service company by pooling the savings of the public. It is invested in a diversified portfolio with a view to spreading and minimising risk. The fund provides investment avenue for small investors who cannot participate in the equities of big companies. It ensures low risks, steady returns, high liquidity and better capital appreciation in the long run.

**(v) Factoring:** factoring is a method of financing whereby a company sells its trade debts at a discount to a financial institution. In other words, factoring is a continuous arrangement between a financial institution, (namely the factor) and a company (namely the client), which sells goods and services to trade customers on credit. As per this arrangement, the factor purchases the client's trade debts including accounts receivables either with or without recourse to the client, and thus, exercises control over the credit extended to the customers and administers the sales ledger of his client.

Factoring refers to the process of managing the sales ledger of a client by a financial service company. In other words, it is an arrangement under which a financial intermediary assumes the credit risk in the collection of book debts for its clients. The entire responsibility of collecting the book debts passes on to the factor. His services can be compared to a del credere agent who undertakes to collect debts. But, a factor provides credit information, collects debts, monitors the sales ledger and provides finance against debts. Thus, he provides a number of services apart from financing.

**(vi) Forfaiting:** Forfaiting has been defined as "the non-recourse purchase by a bank or any other financial institution, of receivables arising from an export of goods and services." Forfaiting is a technique by which a forfaitor (financing agency) discounts an export bill and pays ready cash to the exporter who can



concentrate on the export front without bothering about collection of export bills. The forfaitor does so without any recourse to the exporter and the exporter is protected against the risk of non-payment of debts by the importers.

**(vii) Venture capital:** The term 'Venture Capital' is understood in many ways. In a narrow sense, it refers to, investment in new and untried enterprises that are lacking a stable record of growth.

In a broader sense, venture capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specialising in new ideas or new technologies. It is not merely an injection of funds into a new firm, it is a simultaneous input of skill needed to set up the firm, design its marketing strategy and organise and manage it. It is an association with successive stages of firm's development with distinctive types of financing appropriate to each stage of development.

A Venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project. It is in contrast to the conventional "security based financing". Much thrust is given to new ideas or technological innovations. Finance is being provided not only for 'start-up capital' but also for 'development capital' by the financial intermediary.

**(viii) Custodial Services:** It is yet another line of activity which has gained importance, of late. Under this, a financial intermediary mainly provides services to clients, particularly to foreign investors, for a prescribed fee. Custodial services provide agency services like safe keeping of shares and debentures, collection of interest and dividend and reporting of matters on corporate developments and corporate securities to foreign investors.

(ix) **Corporate Advisory Services:** Financial intermediaries particularly banks have set up corporate advisory service branches to render services exclusively to their corporate customers. For instance, some banks have extended computer terminals to their corporate customers so that they can transact some of their important banking transactions by sitting in their own office. As new avenues of finance like Euro loans, GDRs etc. are available to corporate customers; this service is of immense help to the customers.

x) **Securitisation :** Securitisation of debt or asset refers to the process of liquidating the, illiquid and long term assets like loans and receivables of financial institutions like banks by issuing marketable securities against them. In other words, it is a technique by which a long term, non-negotiable and high valued financial asset like hire purchase is converted into securities of small values which can be tradable in the market just like shares.

Securitisation is a technique whereby a financial company converts its ill-liquid, non-negotiable and high value financial assets into securities of small value which are made tradable and transferable. A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc. which are long term in nature and which are non-negotiable. In such cases, securitisation would help the financial institution to raise cash against such assets by means of issuing securities of small values to the public. Like any other security, they can be traded in the market. It is best suited to housing finance companies whose loans are always long term in nature and their money is locked up for a considerable long period in real estates. Securitisation is the only answer to convert these ill-liquid assets into liquid assets.

(xi) **Derivative Security:** A derivative security is a security whose value depends upon the values of other basic variables backing the security. In most cases, these variables are nothing but the prices of traded securities. A derivative

security is basically used as a risk management tool and it is resorted to cover the risks due to price fluctuations by the investment manager. Just like a forward contract which is a derivative of a spot contract, a derivative security is derived from other trading securities backing it. Naturally the value of a derivative security depends upon the values of the backing securities. Derivative helps to break the risks into various components such as credit risk, interest rates risk, exchange rates risk and so on. It enables the various risk components to be identified precisely and priced them and even traded them if necessary. Financial intermediaries can go for derivatives since they will have greater importance in the near future. In India some forms of derivatives are in operation. Example: Forwards in forex market.)

**(xiii) Lines of Credit (LOC):** It is an innovative funding mechanism for the import of goods and services on deferred payment terms. LOC is an arrangement of a financing institution/bank of one country with another institution/bank/agent to support the export of goods and services so as to enable the importers to import on deferred payment terms. This may be backed by a guarantee furnished by the institution/bank in the importing country. The LOC helps the exporters to get payment immediately as soon as the goods are shipped, since, the funds would be paid out of the pool account with the financing agency and it would be debited to the account of the borrower agency/importer whose contract for availing the facility is already approved by the financing agency on the recommendation of the overseas institution.

**(i) Commercial Paper:** A commercial paper is an unsecured promissory note issued with a fixed maturity by a company approved by RBI, negotiable by endorsement and delivery issued in bearer form and issued at such discount on the face value as may be determined by the issuing company.

A commercial paper is a short-term negotiable money market instrument. It has the character of an unsecured promissory note with a fixed maturity of 3

to 6 months. Banking and non-banking companies can issue this for raising their short-term debt. It also carries an attractive rate of interest. Commercial papers are sold at a discount from their face value and redeemed at their face value. Since its denomination is very high, it is suitable only to institutional investors and companies.

**ii) Treasury Bills:** Treasury bills are short-term promissory notes issued by the Government of India at a discount generally with maturities for 90 days. They are issued when the Government needs to borrow funds.

A treasury bill is also a money market instrument issued by the Central Government. It is also issued at a discount and redeemed at par. Recently, the Government has come out with short-term treasury bills of 182-day bills and 364-day bills.

**(iii) Certificates of deposit:** Certificate of Deposits are short term deposit instruments issued by banks and financial institutions to raise large sums of money.

The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also a money market instrument and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity. As such, it has a secondary market too. Since the denomination is very **high, it is suitable to mainly institutional investors and companies.**

**iv) Inter-bank Participations (IBPs):** The scheme of inter-bank participation is confined to scheduled banks only for a period ranging between 91 days to 180 days. This may be 'with risk' participation or 'without risk' participation. However, only a few banks have so far issued IBPs, carrying an interest rate ranging between 14 and 17 per cent per annum, this is also a money market instrument.

**v) Zero interest convertible debenture/bonds:** As the very name suggests, these instruments carry no interest till the time of conversion which after a fixed period of time. These instruments are converted into equity shares after a period of time.

**vii) Index-linked gilt bonds:** These are instruments having a fixed maturity. Their maturity value is linked to the index prevailing as on the date of maturity. Hence, they are inflation-free instruments.

**(viii) Option bonds:** These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity. But, in the case of non-cumulative bond, the interest is paid periodically. This option has to be exercised by the prospective investor at the time of investment.

**(ix) Secured Premium Notes:** These are instruments, which carry no interest for three years. In other words, the interest will be paid only after 3 years, and hence, companies with high capital-intensive investments can resort to this type of financing.

**(x) Medium term Debentures:** Generally, debentures are repayable only after a long period. But, these debentures have a medium term maturity. Since they are secured and negotiable, they are highly liquid. These types of debt instruments are very popular in Germany.

**(xi) Variable rate debentures:** Variable rate debentures are debt instruments. They carry a compound rate of interest, but this rate of interest is not a fixed

one. It varies from time to time in accordance with some pre-determined formula as we adopt in the case of Dearness Allowance calculations.

**(xii) Non-convertible Debentures with equity warrants:** Generally debentures are redeemed on the date of maturity. But, these debentures are redeemed in full at a premium in installments as in the case of anticipated insurance policies. The installments may be paid at the end of 5th, 6th, 7th and 8th year from the date of allotment.

xiv) **Cumulative convertible preference shares:** These instruments along with capital and accumulated dividend must be compulsorily converted into equity shares in a period of 3 to 5 years from the date of their issue, according to the discretion of the issuing company. The main object of introducing it is to offer the investor an assured minimum return together with the prospect of equity appreciation. This instrument is not popular in India.

**(xvii) Easy Exit Bond:** As the name indicates, this bond enables the small investors to encase the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.

**(xviii) Retirement Bond:** This type of bond enables an investor to get an assured monthly income for a fixed period after the expiry of the 'wait period' chosen by him. No payment will be made during the 'wait period.' The longer the wait period, the higher will be the monthly income. Besides these the investor will also get a lump sum amount on maturity.

**(xix) Regular Income Bond:** This bond offers an attractive rate of interest payable half yearly with the facility of early redemption. The investor is assured of a regular and fixed income.

### **PRODUCT LEVELS**

Product is a key element in the market offering. Marketing mix planning begins with formulating an offering to meet target customers' need and wants. The customer will judge the offering by three basic elements: product features and quality, services mix and quality, and price appropriateness. A product is anything that can be offered to a market to satisfy a want or needs.

At the time of visualising any product, the marketer thinks of it at four levels.

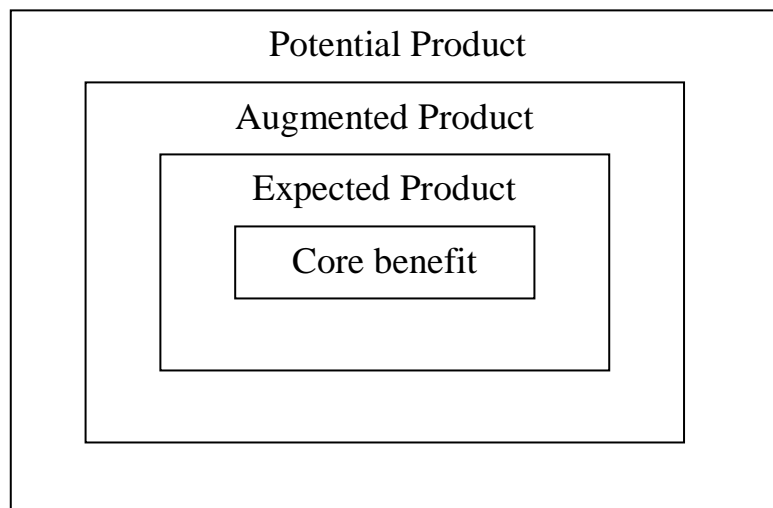


Fig-3.2 Product Levels

1. **Core benefit level :** It is the fundamental service a benefit that the customer is really buying. For example a hotel guest is “buying rest and sleep”. A refrigerator offers the benefits of storing, preserving and cooling a food or similar items.

2. **Expected Product:** It is the set of attributes and conditions that buyer normally expect when they purchase this product (e.g) A hotel guest expect a clean bed, fresh towels and working lamps.
3. **Augmented Product:** It includes additional services and benefit that distinguish the companys offer from competitors offer (e.g.) A hotel can include a remote control television set, fresh flowers, room service and fine dining.
4. **Potential Product :** The Potential Product, which encompasses all the augmentations and transformations that the product might ultimately undergo in the future. While the augmented product describes what is included in the product today, The potential product points to its possible evolution. The company search aggressively for new ways to satisfy customers and distinguish their offer. Example if banking organisation start operation on Sunday or in night Shift, if they start paying interest on the current account deposit, the available potentials are tapped.

### **PRODUCT MIX DECISIONS**

A product mix is the set of all products and items that a particular seller offers for sale to buyers. A Company's product mix has a certain width, length, depth and consistency.

**Width:** The width of product mix refers to how many different product lines the company carries.

**Length:** The length of product mix refers to the total number of items in its product mix.

**Depth:** The depth of product mix refers to how may variants are offered of each product in the line.



**Consistency:** The consistency of the product mix refers to how closely related the various product lines are in and use, Production requirement, distribution channels or same other way.

These four dimensions of the product mix provide the handles for defining the company's product strategy. The company can expand its business in four ways. The company can add new product lines, thus widening its product mix. The company can lengthen each product line. The company can add more product variants to each product and deepen its product mix. Finally, the company can pursue more product – line consistency or less, depending upon whether it wants to acquire a strong reputation in a single field or participate in several fields.

Product mix planning is largely the responsibility of the company's strategic planners.

### **Product Line**

It is a group of products that is closely related because they perform a similar function, targeted at the same customer groups, and marketed through the same channels.

#### **1. Line Stretching.**

Decisions pertaining to line stretching are taken whenever the marketer feels he can increase his profits by either adding or dropping items from the line. It can be upwards, downwards, or both ways.

**Downward stretch** takes place when the company finds that its offerings are at the high price end of the market and then stretch their line downwards. For example, P & G's Ariel detergent began at premium end and then the downmarket *Ariel bar* was introduced to tap the lower segment.

Conversely, **upward stretch** occurs when a company enters the upper end through a line extension. The reasons for this may be a higher growth rate, better margins or simply a wish to be a full line marketer. An example of a successful upward stretch would be that of *Lifebuoy*, which started from a

hygienic bath soap for the masses to a premium quality liquid hand wash for the higher strata of society.

**2. Line filling.** A product line can also be lengthened by adding more items within the present product range. There are several reasons for line filling.

- Reaching for incremental profits.
- Trying to satisfy dealers who complain about lost sales because of missing items on the line.
- Trying to utilise excess capacity.
- Trying to offer a full line of the product.
- Trying to plug holes in the positioning map.

The launch of *Cinthol*, in different variants is an example of line filling. Today Cinthol is a lime soap with yellow packaging and a cologne variation with blue wrapping apart from the initial Cinthol fresh.

The company needs to differentiate each item in the consumer's mind.

### **3. Line modernisation.**

Even when the product line length is adequate, the line might need to be modernised. The issue is whether to overhaul the line completely or one at a time. A piecemeal approach allows the company to see how customers and dealers react to the new style.

In the rapidly changing market, product modernisation is carried out continuously. Because competitors are constantly upgrading their options, each company must redesign their own offering. A company would like to upgrade customers to higher-valued, higher-priced items. A major issue is the timing of the product line improvements so that they do not happen too early and damage the sales of their current product line, or come out too later so that the competition can establish a strong foothold.

### **4. Line featuring.**

In the case of durable products, marketers at times select one or a few items to “feature”. The idea is to attract consumers into the showrooms and then try to get them exposed to other models. At times, the marketer will feature a high end item to lend prestige to the product line. These products act as “flagships” to enhance the whole line.

## **BRANDING**

### **What is Branding**

The American Marketing Association defines a Brand as “A brand is a name , term ,sign, symbol, or design, or combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors”

Branding is a process, a tool, a strategy and an orientation.

- Branding is the process by which a marketer tries to build long term relationship with the customers by learning their needs and wants so that the offering (brand) could satisfy their mutual aspirations.
- Branding can be viewed as a tool to position a product or a service with a consistent image of quality and value for money to ensure the development of a recurring preference by the consumer.
- Branding can be used as a differentiation strategy when the product cannot be easily distinguished in terms of tangible features.

Brand building is a conscious customer-satisfaction orientation process. The brand owner tries to retain customers to its fold over their competitors by a mix of hardware and software because when a customer feels satisfied he/she develops a kind of loyalty for the same.

### **STRATEGIC RELEVANCE OF BRANDING**

Brand is much more than the name per se or the creation of an external indication that the product or service has received an organisation’s imprint or its mark. The strategic relevance and logic of branding outlines.

### **A Brand Aims to Segment the Market**

Brand building is part of a strategy aimed at differentiating the offering companies try to better fulfil the expectations of specific groups of customers. The company wants to leave its mark on a given field, and sets its imprint on the particular offering.

### **A Brand Starts with a Big Idea**

The first task in branding building: defining just what the brand infuses into the product or service. Branding, however, is not based on what goes on, but what goes in. The result is an augmented product or service which must be indicated in one way or the other if it is to be noticed by potential buyers.

### **A Brand has an Enduring Value**

If a brand is merely a label, then such a product would lose its value as soon as it loses its sign of brand identification. Instead, it continues to incarnate the brand: the brand's passing presence has transformed the product. This explain the value of Lux soap when it carries the HLL label for the past 75 years.

### **A Brand Tries to Protect Your Innovation**

Brands become known through the products they create and bring on to the market. Whenever a brand innovates, it generates 'me-too-ism'. Any progress made quickly becomes the standard to which buyers become accustomed to. In other words, the role of brand name is to protect the innovation - it creates a "mental" patent. This is nothing other than the just reward for innovation, making on effort, and taking risks. A snapshot of a given market will often show similar products. A dynamic vision, however, reveals who has innovated and pulled the competition along in the wake of its success.

### **A Product may Die but the Brand will Sustain**

A brand protects the innovator, granting momentary exclusiveness and rewarding the willingness to take risks. Brands cannot be reduced to a symbol or a product or a merely graphics and cosmetic exercise. A brand is the

signature on a constantly renewed, creative process. Products are introduced, they live and disappear, but the inner or core value of the original brand endures.

### **A Brand is a Living Memory**

The spirit of the brand can only be inferred through its products and its advertising. The content of the brand grows out of the cumulative memory of various acts, provided they are governed by a set of unifying ideas or guidelines.

### **BRAND NAME**

The selection of a proper brand name is the first major step in managing a product. The branding of a product is like naming a new-born child. It basically serves to identify the offering. A brand name could be any word, term, sign or symbol that identifies and distinguishes one product from another. For example, it could be

- A word with no meaning related to the product it represents, viz., *Nirma, Titan, Vimal, Charms, Konica, etc.*
- the name of the manufacturer of the product, viz, Bajaj, Godrej, Tata, Kirloskar, etc.
- a combination of numerals and alphabets, viz., No. 10, RX 100, LIV 52, or a word whose meaning suggests some function's or quality of the product. For example, brand names like Quickfix (adhesive), Band-aid (bandage), Duroply (plywood), *Sunflame (gas, stove)*, etc., indirectly indicate the use of the product. Similarly, brand names for cosmetic should preferably suggest beauty and glamour. Brand names for food products could convey a message of taste or health.

A brand name may manipulate the buyer's perception about the product.

Brand names are often useful in establishing an overall product concept.

### **Selection of Brand Name**

The selection of brand names is closely related to the desired positioning and a number of other considerations. As mentioned above, a good brand name should basically possess qualities of distinctiveness. That is, it should be short,

noticeable, impressive, easy-to-remember and should stand out **among a host of** competing name.

Generally, a good brand name should be:

- short, simple and easy to pronounce;
- easy to recognise and remember;
- pleasing when pronounced;
- not offensive, obscene or negative;
- adaptable to packaging, labelling requirements and to any advertising medium; and
- contemporary

### **Companies' Perspective on Brand Names**

Companies follow different policies in choosing brand names for the wide range of products they market. These are briefly discussed here:

#### **1. Individual brand names**

Some companies choose distinct names for each of their offerings. For instance, Hindustan Lever, HMT etc., have been following this method of giving different names to each of their products.

#### **2. Family branding**

Some companies use a common or successful family name, also known as **umbrella branding**, for several products. For instance, Ponds is a mother brand name used for shampoos, talcum powder, cold creams and toilet soaps, etc. Family brand strategy is usually pursued to derive the best advantage of the goodwill attached to some erstwhile successful brand name. For example, the name *Amul* has been used to market a large variety of dairy products.

#### **3. Corporate name.**

Some companies have been found to utilise their corporate name or logo together with some brand names of individual products. For instance, the corporate name of *Godrej, Tata* etc., have been used to market a wide variety of products.

#### **4. Alpha – numeric names**

In many industrial products, an alpha-numeric name often signifies its physical characteristics, performance and technical specifications. In marketing products like machinery, two-wheelers, personal computers, etc., the use of alpha-numeric names often enables companies to distinguish variations in different models, features, etc.

#### **Trademarks**

Popular brands are more susceptible to imitation. A trade mark is a legal right to protect a brand name or brand mark, used by many marketer to assure the customers that they are purchasing an authentic brand at a time when piracy is evidently on the rise.

#### **HOW TO BUILD A BRAND**

Brand building is a continuous process. The model may be used to illustrate the salient steps of various inputs, outcomes, and assessment.

#### **Inputs**

- Identification of key customer groups or segments.
- Understanding customer expectations, needs and aspirations.
- Assessing competitive offering including substitutes.
- Building customer confidence by
  - Customizing the product,
  - Establishing key image of the brand,
  - dealer support – easy availability and push,
  - innovative communication and promotion schemes, and
  - elegant packaging.
- Total brand management – both hardware and software aspects

#### **Outcome**

- Market share
- New customers attracted
- Customer loyalty index

- Increased profitability
- Brand knowledge

### **Assessment**

- Continuous feedback from customers as well as trade channels.
- Scientific inquiry into customer satisfaction determining.
  - Who is the customer and profile of the target segment,
  - What constitutes customer satisfaction.
  - designing the scale to measure customer satisfaction, and
  - measuring current levels of customer satisfaction,
  - trend analysis and pointers for management of customer satisfaction.
  - Brand strength.

### **Managing Brand Equity**

Brand equity is the term used to describe the value of a brand's name or symbol. The simplest form of brand equity is familiarity. Choosing a known brand gives the customer a justification for the decision. This justification may also serve as a social approval, indicating that the person has bought something of value.

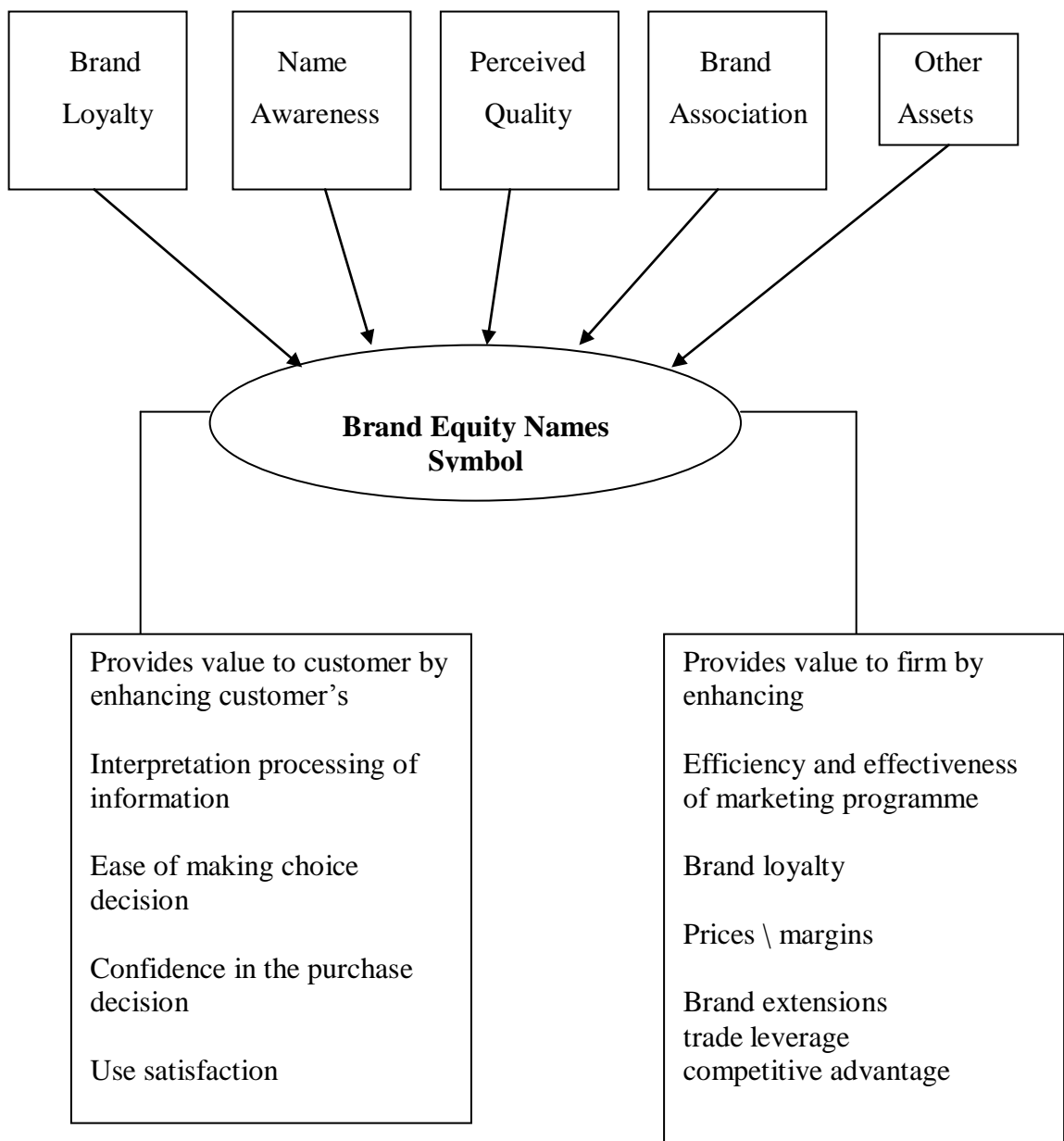
Brand equity is defined as a set of brand assets and liabilities linked with a particular brand, its name and symbol. Brand equity creates value for both customers and the marketer. Aakar has proposed a structure (see Fig. 3.3) of five assets underlying brand equity; these are now briefly described.

1. Brand loyalty: Higher loyalty to a brand is an important asset. It can be utilised to persuade customers for more purchase or for spreading word of mouth.
2. Name awareness: Creating name awareness is a necessary condition for trial. Customers rarely purchase an unknown brand.
3. Perceived quality: A known brand often conveys an aura of quality. Customers own judgement about quality induces purchase action.



4. Brand associations: Customers attach certain subjective and emotional attachments which form a part of the brand equity. These associations together form a brand “personality” which suggests situations and customers for whom the particular brand is suitable.
5. Other assets: Patents, trademarks etc. are valuable other assets of a brand.

Fig. 3.3 Managing Brand Equity

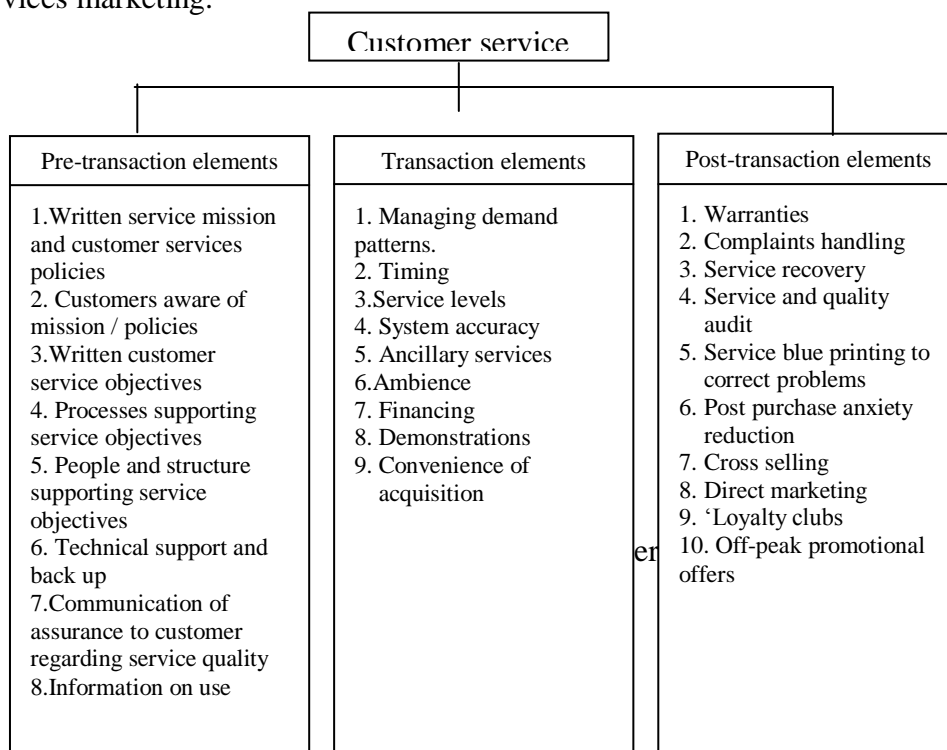


## CUSTOMER SERVICE STRATEGY

Customer is concerned with the building of bonds with customers and other markets or groups to ensure long-term relationships of mutual advantage which reinforce the other marketing mix elements. Customer service can thus be seen as an activity which provides time and place utilities for the customer and which also involves pre-transaction and post-transaction considerations relating to the exchange process with the customer. Some of the key elements are shown in Figure 3.4 The provision of high levels of customer service involves understanding what the customer buys and determining how additional value can be added to the offer.

Customer service was generally considered important by most respondents. Overall, it was rated ahead of advertising, promotion and sales effort in terms of importance and ranked third behind product and price.

However, because of the inseparability and intangibility characteristics of services, customer service in service business is usually more important than it is in manufacturing companies. Leading service firms are recognizing that warranties unconditional service guarantees and free phone –in advice centres such as General Electric’s are critical to creating differential advantage in services marketing.



Service companies are now realizing, the importance of building upon their existing client base, increasing their understanding of client needs and creating additional cross-selling opportunities to tie their customers more closely to them. In order to do this employees need to be trained to take a pride in providing the best possible customer service to match the client's requirements. Services have a particular advantage in that very often there is close personal contact between the service provider and customer. This represents an opportunity to provide excellent customer service; but it also provides an opportunity for a poorly trained employee to destroy the relationship between the customer and the company.

### **Customer service strategy**

Christopher has outlined four key steps in creating a customer service strategy.

**1. Identifying a service mission.** A service company should articulate its service commitment and values either within its corporate mission and/or in a separate customer service mission statement which reflects the company's philosophy and commitment to customer service.

**2. Setting customer service objectives.** This involves answering questions such as:

How important is customer service compared with the other marketing mix elements?

Which are the most important customer service elements?

How do these vary by market segment?

In considering levels of performance in setting these objectives, service companies need to consider the importance of service quality variables such as reliability, responsiveness, assurance, empathy and tangibles.

Customer service objectives need to be considered in the context of pre-transaction, transaction and post-transaction activities. This involves

understanding what customers value, and their cost base, and developing a value proposition superior to that of competitors

**3. Customer service strategy.** The most markets consist of market segments, which seek different combinations of benefits .As not all customers require the same level of service, segmentation can be a powerful means of creating appropriate service packages for each relevant market segment.

Christopher's approach to developing a service-based strategy consists of four parts:

identify service segments;

identify most important products and customers;

prioritize service targets; and

develop the service package

Market research can be used to identify the key components of customers service and their relative importance, and develop service segments. Pareto analysis can then be used to focus on the most important products and/or customers and specific service targets can then be prioritized. Finally, an appropriate service package can be developed which aims at offering benefits of greater value to customers than those of competing products. The benefits may be real or perceived.

**4. Implementation.** Once the most effective service package has been developed for each segment the company wishes to pursue it should then become part of an integrated marketing mix. For service-sensitive sectors such as airlines the service attributes can be used as part of the promotional campaign. British Airways and SAS are good examples of service organizations 'using service to sell.'

A service company should focus especially on customer service and keep customer satisfaction levels under constant review. Usually there is a need for a complaint system which allows unhappy customers to be identified and

corrective action taken. Above all else, a service company needs to stay in touch with the changing needs of its customers in terms of customer service.

Many service companies have recognized the importance of customer as a competitive weapon.

## **NEW PRODUCT DEVELOPMENT**

### **CLASSIFICATION OF NEW PRODUCTS**

The term 'new' is used in a relative sense. In the recent past, new product launches in India have shown that these launches can be broadly classified into three categories:

#### **1. Marketing Innovations**

Companies have made improvements on existing products and have launched these as new products in the market. For instance, *Maggi* noodles, soft drinks in tetrapack, *Shrikhand*, *Pan Parag*, etc. are basically slightly altered versions of existing or old products.

#### **2. Product improvements**

The launch of 100 cc two-wheelers, radial tyres, instamatic cameras are basically slight innovations on the technology/design of existing products, although the product category as such already existed in its primitive form.

#### **3. Technological innovations**

The Indian market has experienced a rapid induction of products like personal computers, photocopiers and colour televisions. Generally, these products require some kind of assembling of imported kits.

### **ROUTES OF NEW PRODUCTS DEVELOPMENT**

- Transfer of technology
- Penetration of new market

- New product lines
- Product line extension
- Cost reduction
- Repositioning or product re-launch

### **1. Transfer of technology.**

New products have often been launched, based of new technology, either acquired from the parent company or with foreign collaboration. Launch of the personal computer or photocopying machine is a move in this direction.

### **2. Diversification.**

Sometimes companies have entered into new lines of business(es) and catered to altogether new markets for the first time. DCM's entry into the LCV market fits into this category. Similarly, ITC's decision to enter into hotels. Paperboards, edible oil, tissue paper is a diversification strategy.

### **3. Additions to existing product lines.**

New product lines and brand extensions have sometimes supplemented a company's existing business. Videocon's entry into washing machines and music systems from colour televisions is a case in point.

### **4. Improvements/Revisions in existing products.**

New products that offer superior performance and replace existing products are another way of entering the market. More recently Bata has successfully launched many sportswear, fashion jeans, and apparels.

### **5. Cost reductions.**

New products that provide similar performance at lower cost (e.g. Nirma detergent, Tata-407 LCV)

### **6. Product relaunch.**

Sometimes old products have been relaunched with minor improvements and targeted at completely new markets or consumer segments, e.g. the launch

of many food products like Good day biscuits, Tata Tea, Pan Parag etc. fall under this type of new product launches.

## **NEW PRODUCT DEVELOPMENT PROCESS**

How are new products developed? Typically, the product development process consists of the following stages:

### **1. Idea generation.**

The process of generating new ideas may consist of brainstorming, attribute listing, focus group discussions, or problem inventory analysis. Broadly speaking, it involves creative thinking and technological developments. But sources of new ideas could be varied, as explained below.

#### **Sources of New Product Ideas**

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- **Customers :** Customers are sometimes able to discuss their requirements and offer ideas that will meet those problems.
  - **Competitors :** Systematic comparison or benchmarking with the competition may offer good source of new product ideas.
  - **Distributors :** Suggestions from distributors and their problems handling present products often throw up new ideas.
  - **Creative techniques :** Brainstorming, focussed interviews and technological forecasting enable one to find out the latent capabilities of innovations.
  - **External world :** The external world, especially the use of their technology, offers a good source of ideas for implementation in the home market.
  - **Research and Development :** Create new product ideas through R & D
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## **2. Screening**

This involves a thorough analysis of new ideas from the point of view of the consumers reactions to the new product. Techniques for evaluating new ideas may consist of a series of open discussions with those concerned, where ideas are minutely scrutinised so that market failures can be minimised. Different core concepts are tested among consumers.

The Characteristic of a strong product concept would be either to offer entirely new benefits not offered by existing products, or else to offer some secondary benefits in addition to the major existing benefits. Some negative aspects of the existing products may be eliminated, or a price advantage over available alternative may be offered. Finally, the new concept could position the product to fit into the emerging trends in society.

## **3. Business analysis.**

Product ideas that pass the screening process are subjected to business analysis. Ultimately, more concrete business recommendations are arrived at. This includes specifying product features and information or resources needed in production. The analysis makes as assessment of market demand, cost projections, investment requirements and even of the existing competition.

## **4. Prototype development .**

During this stage, the new product idea is transformed from a concept to a prototype, outlining the physical characteristics of the product, package designs, brand name etc. while the concept is evaluated from many marketing angles apart from examining production requirements, cost and other modifications necessary before entering into the test marketing stage. Here, a major activity involves obtaining consumer feedback on different prototype models. Typically, consumers are given a sample to test the proposed new product. This activity is popularly known as “ **concept testing**”.

## **Concept Development**

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Concept development involves asking questions such as the following:

- **Need** : Do customers find a strong perceived need for the benefit offered?
- **Trust** : Do they believe that the new product has the benefits claimed?
- **Communicability** : Do customers easily understand the key benefits being offered ?
- **Usage** : Does it offer easy adoption ?
- **Perceived value** : Do customers see it as offering value at the price being considered

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## 5. Test marketing.

Test marketing is an experimental procedure that provides an opportunity to examine the prospect of the new product under realistic market conditions to obtaining a first hand measure of the potential sales volume in national distributions. The new product is marketed on an experimental basis in a few pockets of the market, choosing some cities and small geographic areas.

Test marketing serves two important functions. It provides an opportunity to assess the outcome of an alternative course of action. Marketers can vary the different marketing mix elements and assess their impact on sales before the optimum course of action is taken. This allows management to identify and correct weaknesses in either the product or its marketing programme before launching the product on a national scale. Thus, if the test market results show any kind of failure or weakness, the product may be reformulated or the marketing mix may be changed in view of the feedback. Therefore, the setting up of test markets can provide valuable data on the nature of the market, marketing strategy changes and product modifications necessary

to ensure a successful launch. It is worth remembering that one cannot get a second change to make the first impression.

#### **6. Commercialisation :**

This refers to the decision to market the new product at the full scale of operation, which involves a significant commitment of resources and managerial effort.

#### **Why do New Products Fail ?**

- 1. Lack of differential advantage.** Products fail when customers do not perceive them as better value than existing options.
- 2. Too Slow development .** Speed of entry or design of new products is essential in the changing market where technology is readily available.
- 3. Poor planning.** Error in judgement about target market/segment, in accurate positioning often misses the opportunities.
- 4. Lack of management enthusiasm.** Management is at times, complacent and avoids into new area.
- 5. Lack of organisation's expertise.** Managing new products may call for expertise which an organisation may sometimes lack.
- 6. Assigning inadequate resources to market development.** Presuming that the product is so good that it will sell on its own can prove to be wrong as special efforts of market development are required.
- 7. Lack of genuine superiority.** If a new product is merely an imitation of some existing product, but claims superiority with which the consumers do not quite agree, the product will fail sooner or later.
- 8. Underestimating the competition.** Underestimation of competitors' capabilities and possible reaction is at times the cause of product failure. If the product launch is based on a lower cost of production and the assurance of good channel support. It may face its match by competitors.

**9. Poor market research.** The wrong reading of consumers' mind and arriving at an optimistic forecast of market demand is sometimes the reason for product failure.

**10. Poor timing of launch.** Too early or too late an entry into the market is also a common cause of failure.

**11. Technical problems.** Products have sometimes failed because of bottlenecks in production or design etc.

### **THE CONCEPT OF THE PRODUCT LIFE CYCLE**

To say that a product has a life cycle is to assert four things:

- 1) Products have a limited life.
- 2) Product sales pass through distinct stages, each posing different challenges, opportunities, and problems to the seller.
- 3) Profits rise and fall at different stages of the product life cycle.
- 4) Products require different marketing, financial, manufacturing, purchasing and human resource strategies in each stage of their life cycle. Most product life-cycle curves are portrayed as bell-shaped. This curve is typically divided into four stages: introduction, growth, maturity and decline.

1. **Introduction :** A period of slow sales growth as the product is introduced in the market. Profits are none existent in this stage because of the heavy expenses incurred with product introduction.
2. **Growth :** A period of rapid market acceptance and substantial profit improvement.
3. **Maturity:** A period of a slowdown in sales growth because the product has achieved acceptance by most potential buyers. Profits stabilize or decline because of increased competition.
4. **Decline.** The period when sales show a downward drift and profits erode.

## **MARKETING STRATEGIES: INTRODUCTION STAGE**

Profits are negative or low in the introduction stage because of low sales and heavy distribution and promotion expenses. Much money is needed to attract distributors. Promotional expenditures are at their highest ratio to sales because of the need to (1) inform potential consumers, (2) induce product trial, and (3) secure distribution in retail outlets. Firms focus their selling on those buyers who are the readiest to buy, usually higher-income groups. Prices tend to be high because costs are high due to relatively low output rates, technological problems in production, and high required margins to support the heavy promotional expenditures.

In launching a new product, marketing management can set a high or a low level for each marketing variable (price, promotion, distribution, product quality). Considering only price and promotion, management can pursue one of four strategies.

- 1. Rapid skimming:** Launching the new product at a high price and a high promotion level. This strategy makes sense when a large part of the potential market is unaware of the product; those who become aware of the product are eager to have it and can pay the asking price; and the firm faces potential competition and wants to build brand preference.
- 2. Slow skimming:** Launching the new product at a high price and low promotion. This strategy makes sense when the market is limited in size; most of the market is aware of the product; buyers are willing to pay a high price; and potential competition is not imminent.
- 3. Rapid penetration:** Launching the product at a low price and spending heavily on promotion. This strategy makes sense when the market is large, the market is unaware of the product, most buyers are price sensitive, there is strong potential competition, and the unit manufacturing costs fall with the company's scale of production and accumulated manufacturing experience.

4. Slow penetration: Launching the new product at a low price and low level of promotion. This strategy makes sense when the market is large, is highly aware of the product, is price sensitive, and there is some potential competition.

Market pioneer gains the most advantage. Research has shown that consumer often prefer pioneering brand.

#### **The Pioneer Advantage.**

Companies that plan to introduce a new product must decide when to enter the market. To be first can be highly rewarding, but risky and expensive. To come in later makes sense if the firm can bring superior technology, quality, or brand strength. For example coca-cola, Kodak.

#### **MARKETING STRATEGIES: GROWTH STAGE**

The growth stage is marked by a rapid climb in sales. Companies maintain their promotional expenditures at the same or at a slightly increased level to meet competition and to continue to educate the market. Profits increase during this stage as promotion costs are spread over a larger volume and unit manufacturing costs fall faster than price declines owing to the producer learning effect.

During this stage, the firm uses several strategies to sustain rapid market growth as long as possible:

- It improves product quality and adds new product features and improved styling.
- It adds new models and flanker products (i.e. products of different sizes, flavors, and so forth that protect the main product).
- It enters new market segments.
- It increases its distribution coverage and enters new distribution channels.
- It shifts from product-awareness advertising to product-preference advertising.
- It lowers prices to attract the next layer of price-sensitive buyers.

## **MARKETING STRATEGIES : MATURITY STAGE**

At some point, the rate of sales growth will slow, and the product will enter a stage of relative maturity. This stage normally lasts longer than the previous stage, and poses formidable challenges to marketing management. *Most products are in the maturity stage of the life cycle, and most marketing managers cope with the problem of marketing the mature product.*

The maturity stage divides into three phases: growth, stable, and decaying maturity. In the first phase, the sales growth rate starts to decline. There are no new distribution channels to fill. In the second phase, the sales flatten on a per capita basis because of market saturation. Most potential consumers have tried the product, and future sales are governed by population growth and replacement demand. In the third phase, *decaying maturity*, the absolute level of sales starts to decline, and customers begin switching to other products and substitutes.

### **Market Modification**

The company might try to expand the market for its mature brand by working with the two factors that make up sales volume.

Volume = number of brand users x usage rate per user.

The company can try to expand the number of brand users in three ways.

1. Convert nonusers : The key to the growth of air freight service is the constant search for new users to whom air carriers can demonstrate the benefits of using air freight rather than ground transportation.
2. Enter new market segments: Johnson & Johnson successfully promoted its baby shampoo to adult users.
3. Win competitor's customers: Pepsi-Cola is constantly tempting Coca-cola users to switch.

Volume can also be increased by convincing current brand users to increase

their usage of the brand. Here are three strategies: (1) The company can try to get customers to use the product more frequently: Orange juice marketers try to get people to drink orange juice at occasions other than breakfast time. (2) The company can try to interest users in using more of the product on each occasion: A shampoo manufacturer might indicate that the shampoo is more effective with two applications than one. (3) The company can try to discover new product uses and convince people to use the product in more varied ways: Food manufacturers list several recipes on their packages to broaden consumers' uses of the product.

### **Product Modification**

Managers also try to stimulate sales by modifying the product's characteristics through quality improvement, feature improvement, or style improvement.

*Quality Improvement* aims at increasing the product's functional performance – its durability, reliability, speed, taste. A manufacturer can often overtake its competition by launching a “new and improved” product.

*Feature improvement* aims at adding new features (for example, size, weight, materials, additives, accessories) that expand the product's versatility, safety, or convenience.

A strategy of *style improvement* aims at increasing the product's *aesthetic appeal*. The periodic introduction of new car models amounts to style competition rather than quality or feature competition.

### **Marketing – Mix Modification**

Product managers might also try to stimulate sales by modifying other marketing mix elements. They should ask the following questions:

- Prices : Would a price cut attract new buyers ? If so, should the list price be lowered, or should prices be lowered through price specials, volume or early purchase discounts, freight cost absorption, or easier credit terms? Or would it be better to raise the price to signal higher quality ?

- **Distribution** : Can the company obtain more product support and display in existing outlets ? Can more outlets be penetrated ? Can the company introduce the product into new distribution channels? When Goodyear decided to sell its tires via Wal-Mart, Sears, and Discount Tire, it boosted market share from 14 percent to 16 percent in the first year.
- **Advertising**: Should advertising expenditures be increased? Should the message or copy be changed? Should the media mix be changed? Should the timing, frequency, or size of ads be changed?
- **Sales Promotion** : Should the company step up sales promotion – trade deals, cents off coupons, rebates, warranties, gifts, and contests ?
- **Personal selling** : Should the number or quality of sales people be increased ? Should the basis for sales force specialization be changed ? Should sales territories be revised ? Should sales force incentives be revised ? Can sales-call planning be improved ?
- **Services** : Can the company speed up delivery ? can it extend more technical assistance to customers? Can it extend more credit?

Marketers often debate which tools are most effective in the mature stage.

A major problem with marketing mix modifications, especially price reductions and additional services, is that they are easily imitated.

### **MARKETING STRATEGIES: DECLINE STAGE**

The sales of most product forms and brands eventually decline. The decline might be slow.

Sales decline for a number of reasons, including technological advances, shifts in consumer tastes, and increased domestic and foreign competition. All lead to overcapacity, increased price cutting, and profit erosion.

As sales and profits decline, some firms withdraw from the market. Those remaining may reduce the number of products they offer. They may



withdraw from smaller market segments and weaker trade channels, and they may cut their promotion budget and reduce their prices further.

In a study of company strategies in declining industries, Harrigan identified five decline strategies available to the firm:

1. Increasing the firm's investment (to dominate the market or strengthen its competitive position)
2. Maintaining the firm's investment level until the uncertainties about the industry are resolved.
3. Decreasing the firm's investment level selectively, by dropping unprofitable customer groups, while simultaneously strengthening the firm's investment in lucrative niches.
4. Harvesting("milking") the firm's investment to recover cash quickly
5. Divesting the business quickly by disposing of its assets as advantageously as possible.

The appropriate decline strategy depends on the industry's relative attractiveness and the company's competitive strength in that industry.

### **Diffusion of Innovation**

It examines a major issue in marketing and consumer behavior, the acceptance of new products and services. The introduction of new products and services is vital to the consumer and the marketer. For the consumer, the new products and services represent increased opportunities to satisfy personal, social, and environmental needs. For marketer, new products and services provide an important mechanism for keeping the firm competitive and profitable.

The framework for exploring consumer acceptance of new products is drawn from the area of research known as the diffusion of innovations. Diffusion of innovation involve two process: the diffusion process and adoption process

## **The Diffusion Process**

In his comprehensive book *Diffusion of Innovation*, Everett Rogers defines diffusion as the process by which an innovation is communicated through certain channels over time among the members of a social system. Rogers' definition contains four elements that are present in the diffusion process.

### **INNOVATION**

An innovation is an idea, practice, or object that is perceived as new by an individual or other unit of adoption. The characteristics of an innovation, as perceived by the members of a social system, determine its rate of adoption. The characteristics which determine an innovation's rate of adoption are:

(1) relative advantage, (2) compatibility, (3) complexity, (4) trialability, and (5) observability.

- Relative advantage is the degree to which an innovation is perceived as better than the idea it supersedes. The degree of relative advantage may be measured in economic terms, but social prestige, convenience, and satisfaction are also important factors. The greater the perceived relative advantage of an innovation, the more rapid its rate of adoption will be.
- Compatibility is the degree to which an innovation is perceived as being consistent with the existing values, past experiences, and needs of potential adopters. An idea that is incompatible with the values and norms of a social system will not be adopted as rapidly as an innovation that is compatible.
- Complexity is the degree to which an innovation is perceived as difficult to understand and use. Some innovations are readily understood by most members of a social system; others are more complicated and will be

adopted more slowly. New ideas that are simpler to understand are adopted more rapidly than innovations that require the adopter to develop new skills and understandings.

- Trialability is the degree to which an innovation may be experimented with on a limited basis. New ideas that can be tried on the installment plan will generally be adopted more quickly than innovations that are not divisible. An innovation that is trialable represents less uncertainty to the individual who is considering it for adoption.
- Observability is the degree to which the results of an innovation are visible to others. The easier it is for individuals to see the results of an innovation, the more likely they are to adopt it. Such visibility stimulates peer discussion of a new idea, as friends and neighbors of an adopter often request innovation-evaluation information about it.

In summary, then, innovations that are perceived by individuals as having greater relative advantage, compatibility, trialability, observability, and less complexity will be adopted more rapidly than other innovations.

## **COMMUNICATION CHANNEL**

The second main element in the diffusion of new ideas is the communication channel. Communication is the process by which participants create and share information with one another in order to reach a mutual understanding. A communication channel is the means by which messages get from one individual to another. Mass media channels are more effective in creating knowledge of innovations, whereas interpersonal channels are more effective in forming and changing attitudes toward a new idea, and thus in influencing the decision to adopt or reject a new idea. Most individuals evaluate an innovation, not on the basis of scientific research by experts, but through the subjective evaluations of near-peers who have adopted the innovation.

## TIME

The third main element in the diffusion of new ideas is time. The time dimension is involved in diffusion in three ways. First, time is involved in the innovation-decision process. The innovation-decision process is the mental process through which an individual (or other decision-making unit) passes from first knowledge of an innovation to forming an attitude toward the innovation, to a decision to adopt or reject, to implementation of the new idea, and to confirmation of this decision. An individual seeks information at various stages in the innovation-decision process in order to decrease uncertainty about an innovation's expected consequences. The second way in which time is involved in diffusion is in the innovativeness of an individual or other unit of adoption. Innovativeness is the degree to which an individual or other unit of adoption is relatively earlier in adopting new ideas than other members of a social system. There are five adopter categories, or classifications of the members of a social system on the basis on their innovativeness: (1) innovators, (2) early adopters, (3) early majority, (4) late majority, and (5) laggards.

- Innovators are the first 2.5 percent of the individuals in a system to adopt an innovation. Venturesomeness is almost an obsession with innovators. This interest in new ideas leads them out of a local circle of peer networks and into more cosmopolite social relationships. Communication patterns and friendships among a clique of innovators are common, even though the geographical distance between the innovators may be considerable. Being an innovator has several prerequisites. Control of substantial financial resources is helpful to absorb the possible loss from an unprofitable innovation. The ability to understand and apply complex technical knowledge is also needed. The innovator must be able to cope with a high degree of uncertainty about an innovation at the time of adoption. While an innovator may not be

respected by the other members of a social system, the innovator plays an important role in the diffusion process: That of launching the new idea in the system by importing the innovation from outside of the system's boundaries. Thus, the innovator plays a gatekeeping role in the flow of new ideas into a system.

- Early adopters are the next 13.5 percent of the individuals in a system to adopt an innovation. Early adopters are a more integrated part of the local system than are innovators. Whereas innovators are cosmopolites, early adopters are localites. This adopter category, more than any other, has the greatest degree of opinion leadership in most systems. Potential adopters look to early adopters for advice and information about the innovation. This adopter category is generally sought by change agents as a local missionary for speeding the diffusion process. Because early adopters are not too far ahead of the average individual in innovativeness, they serve as a role-model for many other members of a social system. The early adopter is respected by his or her peers, and is the embodiment of successful, discrete use of new ideas. The early adopter knows that to continue to earn this esteem of colleagues and to maintain a central position in the communication networks of the system, he or she must make judicious innovation-decisions. The early adopter decreases uncertainty about a new idea by adopting it, and then conveying a subjective evaluation of the innovation to near-peers through interpersonal networks.
- Early majority is the next 34 percent of the individuals in a system to adopt an innovation. The early majority adopt new ideas just before the average member of a system. The early majority interact frequently with their peers, but seldom hold positions of opinion leadership in a system. The early majority's unique position between the very early and the relatively late to adopt makes them an important link in the diffusion

process. They provide interconnectedness in the system's interpersonal networks. The early majority are one of the two most numerous adopter categories, making up one-third of the members of a system. The early majority may deliberate for some time before completely adopting a new idea. "Be not the first by which the new is tried, nor the last to lay the old aside," fits the thinking of the early majority. They follow with deliberate willingness in adopting innovations, but seldom lead.

- Late majority is the next 34 percent of the individuals in a system to adopt an innovation. The late majority adopt new ideas just after the average member of a system. Like the early majority, the late majority make up one-third of the members of a system. Adoption may be the result of increasing network pressures from peers. Innovations are approached with a skeptical and cautious air, and the late majority do not adopt until most others in their system have done so. The weight of system norms must definitely favor an innovation before the late majority are convinced. The pressure of peers is necessary to motivate adoption. Their relatively scarce resources mean that most of the uncertainty about a new idea must be removed before the late majority feel that it is safe to adopt.
- Laggards are the last 16 percent of the individuals in a system to adopt an innovation. They possess almost no opinion leadership. Laggards are the most localite in their outlook of all adopter categories; many are near isolates in the social networks of their system. The point of reference for the laggard is the past. Decisions are often made in terms of what has been done previously. Laggards tend to be suspicious of innovations and change agents. Resistance to innovations on the part of laggards may be entirely rational from the laggard's viewpoint, as their resources are limited and they must be certain that a new idea will not fail before they can adopt.

The third way in which time is involved in diffusion is in rate of adoption. The rate of adoption is the relative speed with which an innovation is adopted by members of a social system. The rate of adoption is usually measured as the number of members of the system that adopt the innovation in a given time period .

## **SOCIAL SYSTEM**

The fourth main element in the diffusion of new ideas is the social system. A social system is defined as a set of interrelated units that are engaged in joint problem-solving to accomplish a common goal. The members or units of a social system may be individuals, informal groups, organizations, and/or subsystems. The social system constitutes a boundary within which an innovation diffuses.

## **THE ADOPTION PROCESS**

The second major process in the diffusion of innovations is **adoption**. The focus of this process is the stages through which an individual consumer passes while arriving at a decision to *try or not to try or to continue using or to discontinue using* a new product.

### **Stages in the Adoption Process**

It is often assumed that the consumer moves through five stages in arriving at a decision to purchase or reject a new product (1) awareness, (2) interest, (3) evaluation, (4) trial, and (5) adoption (or rejection). The stages in the adoption process can be described as follows.

- 1. Awareness.** During the first stage of the adoption process, Consumers are exposed to the product innovation. This exposure is somewhat neutral, for they are not yet sufficiently interested enough to search for additional product information.
- 2. Interest.** When consumers develop an interest in the product or

product category, they search for information about how the innovation can benefit them.

- 3. Evaluation.** Based on their information, consumers draw conclusions about the innovation or determine whether further information is necessary. The evaluation stage represents a kind of “mental trial” of the product innovation. When the evaluation is satisfactory, the consumer will actually try the product innovation. When the mental trial is unsatisfactory, the product will be rejected.
- 4. Trial.** At this stage, consumers use the product on a limited basis. Their experience with the product provides them with the critical information that they need to adopt or reject.
- 5. Adoption (Rejection)** Based on their trials and/or favourable evaluation, consumer decide to use the product on a full, rather than limited basis, or they decide to reject it.



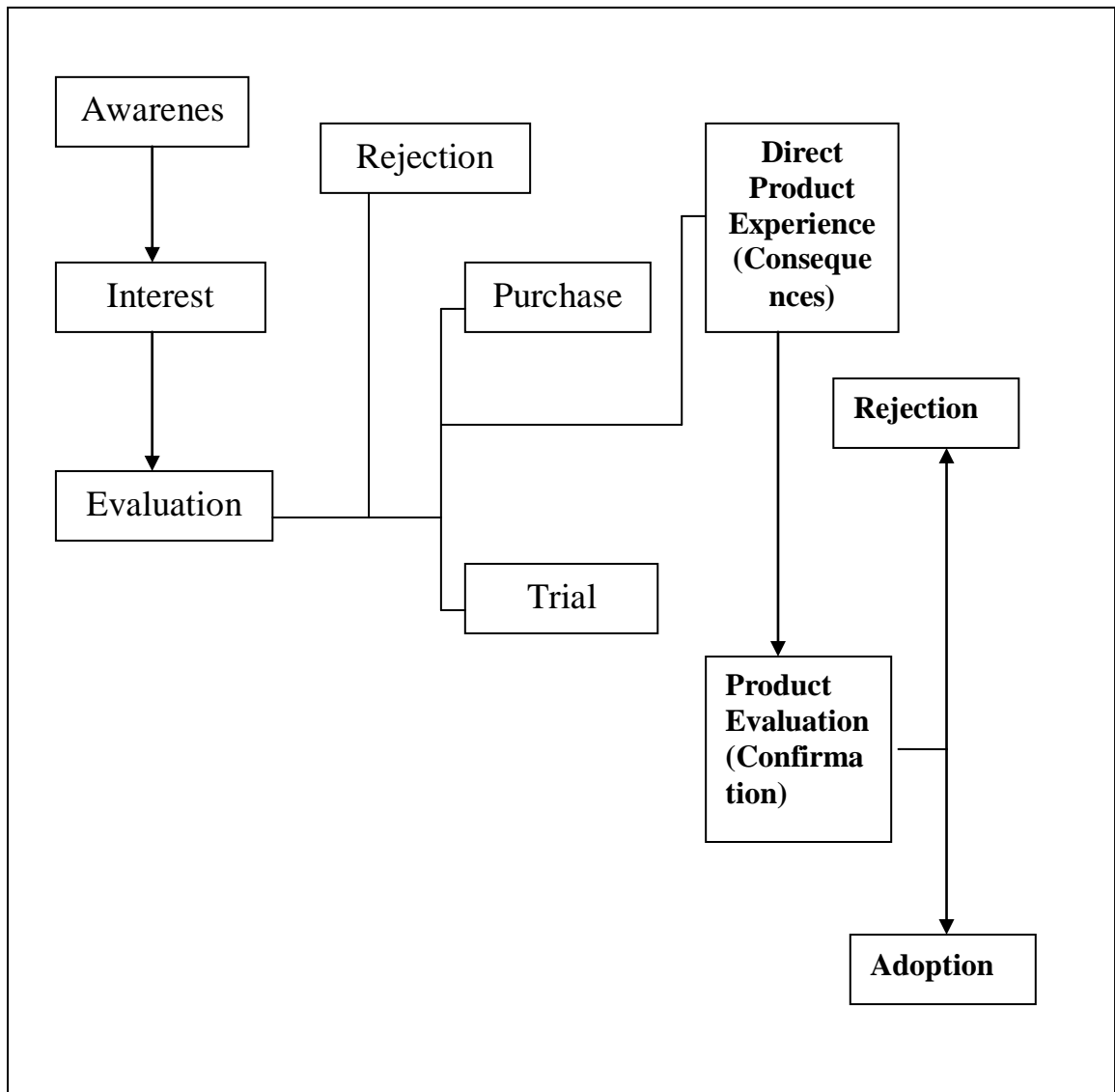


FIG. 3.4 Diffusion of innovation

Questions for Discussion:

1. Explain the steps involved in new product development.
2. Why are new products so important to firms
3. Describe each of the four stages of the product life cycle. For each stages, given an example.
4. What are some considerations is selecting a brand name.

5. Explain the concept diffusion of innovation.
6. Explain the expanded marketing mix for services.
7. Explain the concept of financial products.

**UNIT IV**  
**MANAGEMENT OF FINANCIAL SERVICES**

**I. PRICING**

Pricing decisions have strategic importance in any enterprise.

Price is the only variable factor determining the revenues or income. A variety of economic and social objectives came into prominence in many pricing decisions.

***1) What is Price ?***

Price is the mechanism or device for translating into quantitative terms (Rupees and Paise) the perceived value of the product to the customer at a point of time. We shall define the price as the amount charged for the product or service including any warranties or guarantees, delivery, discounts, services or other items that are part of the conditions of sale and are not paid for separately. To the buyer price is a package of expectations and satisfactions.

Thus, price must be equal to the total amount of benefits (physical, economic, social, ecological and psychological benefits). Any change in the price will also bring about alterations in the satisfaction side of the equation. To the ultimate consumer, the price he pays for a product or service represents a sacrifice of purchasing power.

Price is the only objective criteria for the consumers for comparing alternative items and making the final choice.

Price is equivalent to the total product offering. This offering includes a brand name, a package, product benefits, service after sale, delivery, credit and so on. We can now define price as the money value of a product or service agreed upon in a market transaction. price equation, where;

Money (Price) = Bundle of Expectations or Satisfactions.

***Price-meaning :***

It is the quantity of money that has to be exchanged for one unit of a goods or service.

The price may be of a commodity or of a factor of production. The former is called

‘Commodity-pricing’, the latter ‘Factor-Pricing’ (determination of price of a factor).

***Market Price :***

The price that exists in very short period is known as market price. It is determined by the temporary equilibrium between demand and supply.

***Normal Price :***

The price that is supposed to prevail in the long period is known as normal price. It gets only normal profits to the production.

***Price Determination :***

The process whereby the amount paid for each unit of a goods sold in a market is decided through the interaction of demand and supply influences.

***Price Discrimination :***

It refers to the charging of different prices to different groups of individuals for the same goods or services for reasons not associated with difference in costs. Price discrimination can occur only when the seller has a degree of monopoly power and when his market is divided into segments with which he can deal separately.

***Pricing policy :***

It is the policy or rules adopted by a firm or public enterprise which determines the prices it sets for its products.

***Factor Pricing and Product Pricing***

Though, like product pricing, factor pricing is based on the forces of demand and supply, yet there are fundamental differences between the two which make factor pricing as a distinct theory :

(i) There are differences in the nature of demand for a product and a factor. The demand for a product is direct demand based on its marginal utility, while the demand for a factor is derived from the demand for the product it helps to produce.

(ii) the supply of a product depends on its money cost of production, while the supply of a factor depends on its opportunity cost, the minimum earning which it can earn in the next best alternative use.

(iii) The pricing of some of the factors like labour and entrepreneur is influenced by social and human factors, whereas product pricing is influenced little by these factors. Despite these apparent differences, “the theory of product prices and the theory of factor prices are parts of one whole”.

## ***2. Importance of Pricing :***

Price is matter of vital importance to both the seller and the buyer in the market place. In money economy, without prices there cannot be marketing. Price means the value of a product or service expressed in money.

In a competitive market economy, price is determined by free play of demand and supply. The price will move forward or backward with changing supply and demand conditions. In a free market economy, we have freedom of contract, freedom of enterprise, free competition and right to private property. Price influences consumer purchase decisions. It reflects purchasing power of money. It can determine the general living standards. In essence, by and large, every facet of our economic life is directly or indirectly governed by pricing. Price regulates business profits, allocates the economic resources for maximum production and distribution.

Pricing decisions interconnect marketing actions with the financial objectives of the enterprise. Among the most important marketing variables influenced by pricing decisions are: 1. sales volume, 2. profit margin, 3. rate of return on investment, (ROI)

4. trade margins, 5. advertising and sales sales promotion, 6. product image, 7.

new product development. Hence, pricing decisions play a very important role in the design of the marketing mix. Pricing strategy determines the firm's position in the market vis-a-vis its rivals. Marketing effectiveness of pricing policy and strategy should not suffer merely on account of cost and financial criteria. Hence, all marketing planners must make accurate and planned pricing decisions.

***3) The Significance of the Price Factor :***

The selling price plays a unique role in business because the price level: 1. controls the sales volume and the firm's market share, 2. determines the total sales revenue (sales revenue = sales volume x unit price) 3. regulates the rate of return on investment (ROI) and through ROI price influences sales profitability, 4. creates an impact on unit cost in mass production.

#### **4) Typical Pricing Objectives**

A variety of objectives may guide pricing decision:

**1. Growth in Sales :** A low price can achieve the objective of increase in sales volume. A low price is not always necessary. A right price can stimulate the desired sales increase.

**2. Market Share :** Price is typically one of those factors that carries the heaviest responsibility for improving or maintaining market share.

**3. Predetermined Profit Level :** Return on Investment, say 25 to 30 per cent is a common decision in marketing. Pricing for profit is the most logical of all pricing objectives.

**4. Follow Competition :** Many firms desire the stabilisation of price levels and operating margins as more important than the maintenance of a certain level of short-run profits. The price leader maintains stable prices in the industry. Follow the leader.

**5. Control Cash Flow :** The prime objective of pricing is to return cash as much as possible (funds Invested) within given period. Expenditure must be recovered within a specified period.

#### **5) Market Price :**

The market price is the price determined by the free play of demand and supply. The market price of a product affects the price paid to the factors of production - rent for land, wages for labour, interest for capital and profit for enterprise. Infact, price becomes a basic regulator of the entire economic system because it influences the allocation of these resources.

#### **6) Multistage Price Determination Process :**

The price decisions must take into account all factors affecting both demand price and supply price. The price determination process involves the following steps: 1. Market segmentation 2. Estimate of total demand. 3. Market share, 4. Designing the marketing mix, 5. Estimate of total costs 6. Selecting pricing policies, 7. Determining pricing strategies, 8. Development the price structure.

**1. Market Segmentation :** On the basis of market opportunity analysis and assessment of firms strengths and weaknesses marketers will find out specific marketing targets in the form of appropriate market segments. Marketers will have firm decision on : (a) the type of products to be produced or sold, (b) the kind of service to be rendered, (c) the costs of operations to be estimated,. and (d) the types of customers or market segments sought.

**2. Estimate of Demand :** Marketers will estimate total demand for the products. It will be based on sales forecast, channel opinions and degree of competition in the market.

**3. The Market Share :** Marketers will choose a brand image and the desired market share on the basis of competitive reaction. Market planners must know exactly what his rivals are charging. Level of competitive pricing enables the firm to price above, below, or at par and such a decision is easier in many cases. Higher initial price may be preferred if you expect a smaller market share, whereas if you expect of much larger market share, you prefer lower price.

**4) The Marketing Mix :** The overall marketing strategy is based on an integrated approach to all the elements of marketing mix. It covers :

1. product-market strategy, 2. promotion strategy, 3. pricing strategy, and 4. distribution strategy. All elements of the marketing mix are essential to the overall success of the firm. Price is the strategic element of marketing mix as it influences the quality perception and enables product positioning.

**5) Estimate of Costs :** Straight cost-plus pricing is not desirable always as it is not sensitive to demand. Marketing must take into account all relevant costs as well as price elasticity of demand, if necessary, through market tests.

**6) Pricing Policies :** Price policies provide the general framework within which managerial decisions are made on pricing. Pricing policies are guidelines to carry out pricing strategy. Pricing policy may desire to meet competition or we may have pricing above or below the competition. We may have fixed or



flexible pricing policies. Pricing policies must change and adapt themselves with the changing objectives and changing environment.

**7) Pricing Strategies:** Pricing policies are general guidelines for recurrent and routine issues in marketing. Strategy is a plan of action (a movement or counter movement) to adjust with changing conditions of the market place. New and unanticipated developments may occur, e.g., price cut by rivals, government regulations economic recession, fluctuations in purchasing power of consumers, changes in consumer demand, and so on. Situations like these demand special attention and relevant adjustments in our pricing policies and procedures.

**8) The Price Structure:** Developing the price structure on the basis of pricing policies strategies is the final step in price determination process.

### ***PRICING DECISIONS***

Pricing the product is one of the important element in marketing mix. Until recently it has been one of the most neglected areas. Even today, pricing in some firms is simply based on the concepts of cost, market position, competition and necessary profits.

#### ***Pricing Strategy and the Competitive Situation :***

Pricing strategy changes with competitive situation. Pricing strategy is uncontrollable when management is unable to determine prices. At the other extreme in those rare cases where marketer has a long term monopoly pricing is cent-per cent controllable. Monopolist sets his price to maximise profits by “Charging what the traffic will bear” but in the real world various external pressures prevent him from having a pure monopoly type price.

#### ***Factors Affecting Pricing Decisions***

**1. Objectives of the Business :** There may be various objectives of the firm such as getting a reasonable rate of return, to capture the market, maintenance of control over sales and profits etc. A pricing policy thus, should be established only after proper consideration of the objectives of the firm.

**2. Cost of the Product:** Cost and price of a product are closely related. Normally, the price cannot or shall not be fixed below its cost (including the product, administrative and selling costs). Price also determines the cost.

**3. Market Position.** The prices of the products of different producers are different either because of difference in quality because of the goodwill of the firm. A reputed concern may fix higher prices for its products on the other hand, a new producer may fix lower prices for its products. Competition may also affect the pricing decisions.

**4. Competitors Prices:** Competitive conditions affect the pricing decisions. The company considers the prices fixed and quality maintained by the competitors for their products.

**5. Distribution Channels Policy :** The nature of distribution channels used, and trade discounts which have to be allowed to distributors and the distribution expenses also affect the pricing decisions.

**6. Price Elasticity and Demand Elasticity :** Price elasticity affects the decisions of price fixation. Price elasticity means the consequential change of demand for the change in the prices of the commodity. If demand is elastic, the firm should not fix high prices rather it should fix lower prices than that of the competitors.

**7. Product's Stage in the Life Cycle of the Product :** Pricing decision is affected by the stage of product in its life-cycle. In the introductory stage of the product, it is the price strategy which determines the price of the product.

**8. Product Differentiation :** The price of the product also depends upon the characteristics of the product. In order to attract the customers different characteristics are added to the product such as quantity, size, colour, alternative uses, etc.

**9. Buying Patterns of the Consumers :** If the purchase frequency of the product is higher, lower prices should be fixed to have a low profit margin. It will facilitate increasing the sale volume and the total profits of the firm.

**10. Economic Environment :** In recession period, the prices are reduced to a sizeable extent to maintain the level of turnover. On the other hand, the price and increased in boom period to cover the increasing cost of production and distribution.

**11. Government Policy :** Price discretion is also affected by the price control by the government through enactment of legislation when it is thought proper to arrest the inflationary trend in prices of certain commodities.

#### ***Process of Price Determination of a Product***

Generally the following procedure may be followed.

**1. Estimating the Demand for the Product :** The first step in determining the price of a new product is to estimate the anticipated demand of the product. The estimate of demand at different price levels can be fixed on the basis of elasticity demand of the product. If demand is elastic the price may be fixed lower or in case of inelastic demand prices may be higher.

**2. Anticipating Competition :** Having estimated the demand of the product, competitive situation in the present and in future should also be studied.

**3. Determining Expected Share of Market :** The next step will be to determine the market share which a company will try to capture. It depends on various factors such as present production capacity, cost of extension programmes, cost of production and competition etc.

**4. Selecting a suitable price Strategy :** Keeping in view the business objectives in mind a suitable price strategy should be selected. There are various price strategies to be adopted such as (i) Skimming the cream pricing strategy, (ii) Low penetration pricing strategy, (iii) Discouraging potential competitors.

**5. Companies Marketing Policies :** The marketing policies regarding the following aspect should be considered as a next step.

**a) Production Policies :** In determining the price, the nature of the product should be considered.

**b) Channels of Distribution :** It also affect the pricing of a product.

c) *Promotional Policies* : It also influence the price of the product

d) *Selecting the Price* : Price fixation is based on the ability and experience of the management.

## II. PRICING POLICIES

### *Introduction*

The formulation of price policy and setting of the price are important functions of a managerial economist. Proper pricing enables the expansion of sales. That price helps in maximization of income of a firm. In short setting proper prices will enable increase in sales and income, prices are important for consumers. For all their buying decisions are influenced by prices. Price determines the standard of living of the people. It is the regulator of production and allocator of resources. Price is the universal index of value. It is the best measure of demand.

### *Pricing Policy* :

It is the policy or rules adopted by a firm or public enterprise which determines the prices it sets for its products. For example, it is argued that public enterprises should adopt marginal cost pricing policies. In analysing the pricing policies of private sector firms, economists believe that, if a firm's objective is to maximise profits, its pricing policy will consist of setting a price in such a manner that of the marginal cost equals marginal revenue.

The formulation of a pricing policy by a business firm is influenced by the following aspects :

- a Pricing policy is to be set in the light of competitive situation in the market.
- a Price should aim at maximizing profits.
- a Prices should be set to promote the long-range welfare of the firm.
- a Prices should be adopted in accordance with the diverse competitive situations.
- a Pricing policies should be flexible enough to meet changes in economic conditions.
- a A clear vision of a firms business objective such as survival, growth,

etc. is to set.

- a A pre-determined and systematic method of pricing new products should be introduced by the firm.

***Objectives of Pricing Policy :***

The following are the specific objectives of the pricing policy of a firm:

1. The primary objective of a firm is to maximise its profits.
2. To face the competitive situations in the market.
3. To establish stable prices.
4. Sometimes the producer wants to capture the market. He therefore fixes a lower price at the time of introducing the product in the market.
5. Price decisions are taken on the basis of the ability to customers to pay.
6. The main aim of some concerns is to fix the price of products in the best interest of the firms in the long run.
7. In some cases, reputed firms aim at achieving the target return.

***Factors influencing pricing policy :***

The following are some general considerations which must be kept in view while formulating suitable pricing policy.

1. The pricing policy of a firm must be in conformity with its objectives.
2. A reputed firm may fix a higher price in view of its reputation among customers.
3. A firm considers the prices fixed and the quality maintained by the competitors for their products.
4. Prices cannot be fixed below the cost of production.
5. Pricing policy may be different in different stages of a product's life cycle.
6. Price elasticity of demand affects pricing policies. A high price is fixed for inelastic goods and vice versa.
7. In a non-price sensitive market the price depends on differentiation of the products in its size, colour, quality etc.
8. The purchasing power of the buyers also affect the pricing policy.

9. Fluctuations in trade cycle affect the pricing decision of the firm.

10. Sometimes price fixation depends on government policy.

11. Fair prices are charged in view social and ethical consideration.

Price is an important element in the marketing mix. Arrival at the right selling price is essential in a sound marketing mix. Right price can be determined through pricing research and by adopting the test market techniques. A price policy is the standing answer of the firm to recurring problem of pricing. It provides guidelines to the marketing manager to evolve appropriate pricing decisions. If there is non-price competition, each marketer chooses from among the three

alternatives : -

*i) A Price in Line* (Pricing at the market) : The sale at current market price is desirable under free competition and when a traditional or customary price level exists.

*ii) Market-Plus* (Pricing above the market) : The sale above the market prices under the free competition is profitable only when your product is distinctive, unique and it has prestige or status in the market. Customer is inclined to put a greater value on the product if the package is very good or the brand is well-known.

*iii) Market-Minus* (Pricing below the market): The sale below the market price, particularly at the retail level, is profitable only to large chain stores, self-service stores and discount houses.

**2) Non-Price Competition** : The seller should rely more on non-price factors to capture the consumer demand. At present in many countries business firms avoid price reduction as a means of competition. With or without price competition, increasing emphasis is being given on the various weapons of non-price competition. Non-price competition devices are : 1. Branding, 2. Attractive packaging, 3. Service after sale, 4. Liberal credit, 5. Free home delivery, 6.

Money-back guarantee (return of goods), 7. Sales promotion, 8. Advertising, 9. personal selling (salesmanship)

### **3. Pricing of New Products :**

The problem arises as to what prices should be charged for the new products in the initial stage. There are two pricing policies practically accepted by firms.

a) High initial pricing or Skimming pricing

b) Low initial pricing or Penetration pricing

#### **a) High initial pricing or skimming pricing :**

Under this strategy, the price of a new product is fixed high at the initial stage. Gradually, this price is reduced when competition starts in the market. This strategy is based on the notion that at the initial stage of a product, there is no competition in the market and the price of it may be fixed high.

The firm has to incur heavy expenditure on research, advertisement and sales promotion programme of a new product. Therefore, it is necessary on the part of the firm to keep the price of the product high to recover this expenditure.

The causes for the adoption of the high initial pricing strategy are :

Absence of competition at the initial stage.

Relatively less elastic demand.

Heavy expenditure on a new product.

Suitable for luxurious products.

Every recovery of initial investment.

Earning high rate of profit at the initial stage.

Attracting the consumers of high income group.

**Skim-the-cream Price** (high Pricing) : A manufacturer introducing a new product may adopt this pricing strategy deliberately to build up the image of quality and prestige for his new product.

In the earlier stage of product life cycle, a strategy of high price associates with heavy expenditure on promotion, and at the later stage of the product life cycle,

a strategy of lower prices with normal promotional expenditure pays a rich dividend.

**Reasons for Skimming Price Policy:** There are a few reasons supporting skim-the-cream pricing for a new unique product in its introduction stage: 1. In the initial stage, we have less elastic demand. Price is less important in purchase decisions.

2. When entry of rivals is difficult, costs are uncertain, life-cycle is short, we should prefer skimming price. 3. Skimming price enables the firm to take the cream of the market, at a higher price and then it may attempt to appeal price-sensitive sections of the market by adopting penetration, i.e., lower price. 4. High initial price can keep demand within limit of our productive capacity. 5. It can provide high margin at the initial stage.

There are two **disadvantages** of skimming price : 1. It attracts competition. 2. If entry of rivals is easy, this policy is risky.

**b) Penetration Pricing (Low Pricing) :**

**b) Low initial pricing or Penetration Pricing :**

Under this strategy, the price of a product is fixed low at the initial stage. Gradually this price is increased when the product get popularity in the market. This strategy is based on the notion that a new product can enter into the market easily, if its price is kept low. This pricing strategy is adopted by a new firm or by an existing firm which introduces a new product or by a firm which wants to expand its market. This strategy is very suitable when there is tough competition in the market.

**The causes for the adoption of the low initial pricing strategy are:**

- D Economies of large scale production
- D Low cost of production of a need product.
- D Minimum expenditure on research and advertisement.
- D Suitable when the demand for a new product is relatively elastic.
- D Discouraging competition.



- D Enter and expand the market.
- D Suitable for low income group consumers.
- D Discouraging government intervention.
- D Earning maximum profit through maximum sales.

The approach is favourable under the following conditions: 1. Product has greater elasticity of demand. 2. Mass production provides substantial reduction in unit cost of production. 3. Very strong competition is expected soon after the product enters the market. 4. High-income section of the population is not adequate. We have bulk of the population in the middle and lower income group.

**Reasons for Low Pricing:** When product has long life cycle, it has a mass market, entry of rivals into the market is easier and demand is elastic, penetration price is always preferable as rivals are discouraged to enter the market and you can establish a strong hold on the market share, incidentally making future entry of rivals difficult. The only disadvantages of this pricing is we may have excess demand within a short period.

**5) One-Price vs. Variable Price Policy :**

**i) Under one-price policy,** a seller will charge all similar types of buyers exactly the same price and there will be no discrimination among the buyers of the same commodity. There is no question of negotiation, bargaining. No favouritism is shown to any buyers.

**ii) Under variable-price or negotiated price policy,** the seller will sell same quantities to different buyers at different prices. Certain favoured customers are offered lower prices. The terms of sale, e.g., discounts and allowances are granted on unequal terms to buyers. Sellers commonly use variable pricing for most consumer items. In retail trade the price discrimination is usual.

#### **6) Cost-plus or Mark-up Pricing :**

This method is considered the best approach to pricing. It is based on the seller's per-unit cost of the product plus 'an additional margin of profit. There are four items in determining the sale price : 1. Cost of producing/acquiring goods. 2. Cost of operating/selling expenses. 3. Interest, depreciation, etc. 4. Expected profit margin-mark-up. Cost-plus pricing is very popular in retail trade and wholesale trade. Some form of customary mark-up pricing is most practical in trade, as items for sale are innumerable.

#### **7) Psychological Pricing:**

It is used to create an illusion of a bargain. It is a popular practice of setting the prices at odd points, e.g. Rs.217.95, Rs. 299, Rs. 995, etc. This policy is followed usually in consumer goods industry, e.g. Bata Shoe Company has psychological pricing in shoe prices.

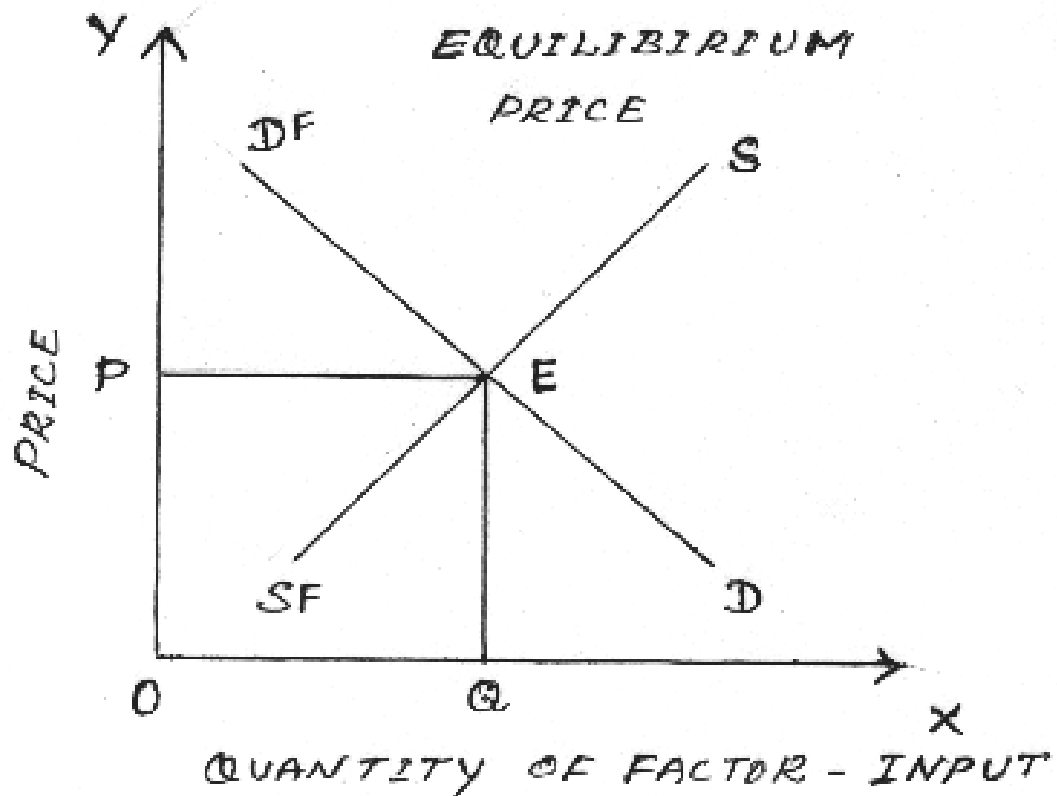
#### **8) Premium Pricing :**

Premium pricing is a mix of 'What the traffic will bear' idea and the value for money. Marketer has a premium product, i.e., superior quality / good variety. He uses best technology. He employs premium promotion programme. He has at his disposal premium distribution process. Hence, he opts out for non-price competition. Thus, he is ready to adopt premium pricing strategy.

### **MODERN THEORY OF FACTOR PRICING**

The Modern theory of factor pricing states that the price of a factor inputs, Just like the price of any other commodity, is determined by its demand and supply.

Factor-inputs are demanded by firms because these help in production of different types of goods. Demand for factor inputs depends upon a number of factors, like (i) the demand for the product that the factor-inputs help to produce (ii) Productivity of the factor, and (iii) Prices of related substitute factors. More generally, demand for a factor-input bears an inverse relation to its price ; demand curve for a factor has a negative slope, as shown in diagram.



Factor-inputs are supplied by their owners, the households. Factor-owners expect to be paid for their services. More generally, Factor-supply bears a direct relation to its price, i.e., supply of a factor goes up with an increase in its price and vice versa. Supply curve of a factor has a positive slope. Equilibrium price of a factor, which determines its present level of earnings, is determined by factor demand and factor-supply, as illustrated in the above diagram.

#### **PRICE DETERMINATION UNDER PERFECT COMPETITION**

***Perfect competition :***

***Meaning:***

Perfect competition is a market situation in which there are large number of buyers and sellers engaged in buying and selling homogeneous products

respectively without any artificial restrictions. Perfect competition is an ideal market structure rather than an actual one in reality.

***Features of perfect Competition :***

1. Large number of buyers and sellers.
2. Existence of homogeneous product.
3. Free entry and Exit of firms.
4. Perfect mobility of factors of production.
5. Perfect knowledge of market conditions among buyers and sellers.
6. Absence of transport costs.

***Benefits of perfect competition:***

1. Perfect competition permits the best and fullest utilisation of economic resources.
2. It is an effective check on the sellers who aim at abnormal profit.
3. It protects the consumers against exploitation and so it is socially useful.
4. There is no need for state intervention to regulate production or prices.

***Conditions of equilibrium under perfect competition:***

1. Marginal Revenue (MR) must be equal to its marginal cost (MC)
2. Marginal Cost curve must cut the marginal revenue curve from below at the equilibrium output.

***Pricing under Perfect Competition:***

Price under perfect competition is determined by the interaction of demand and supply. such a price is called the 'Equilibrium price'.

***a) Demand Side:***

The demand side is governed by the law of Demand based on the marginal utility of the commodity to the buyers. So long as the marginal utility is higher than the price, buyers will be demanding more. As a result, supply will increase. But with additional purchases, the marginal utility will fall and ultimately, the marginal utility will be equal to the price.

***b) Supply side:***

The supply side is governed by the law of supply. It is based on the cost of production. The law of supply states that more will be supplied at higher price and less on low price. If the price offered is lower than the marginal cost of production, the producers will have to curtail supply and production. As a result, demand remaining the same, price will rise again and will be equal to the marginal cost.

***Marshall's view :*** Alfred Marshall has observed that “the price rests like the keystone of an arch balanced in equilibrium between the two contending forces of demand and supply to operate in such a way that a state of equilibrium is attained”.

Prof. Silverman has clearly explained how equilibrium price is determined under perfect

competition. “From the side of demand, the price of an article tends to equal the marginal utility of the estimate of the marginal purchases, while from the side of the supply, it tends to equal the marginal cost of production or the costs incurred by the marginal firm. The point of coincidence between marginal utility and marginal costs as measured in terms of money indicates the price.

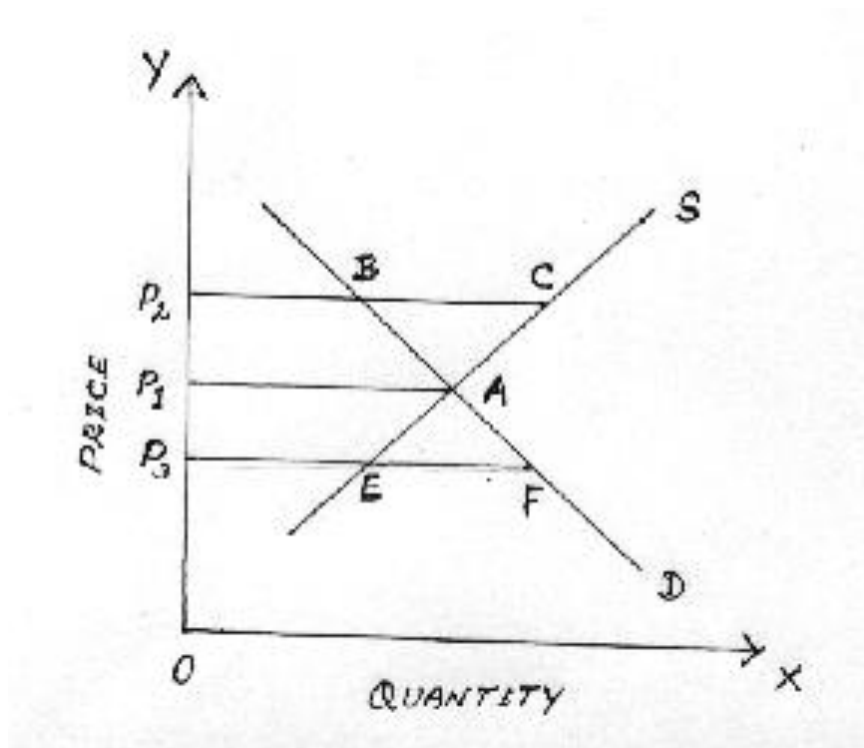
***Diagrammatic Illustration of Equilibrium Price :***

The diagram shows interaction of demand and supply and how equilibrium price is established. The curves D and S are the demand and supply curves. The two curves intersect at point A. The corresponding price is  $OP_1$ . At this price, demand and supply are equal. There is no surplus or shortage.

At a higher price  $OP_2$ , more is supplied but less is demanded. The supply is large  $P_2C$ . But the demand is low at such a higher price, it is only  $P_2B$ . There is excess supply of BC and the price come down. It is obvious that a higher price prevails only for a short time and it is forced down when demand falls.

Similarly, low price also will prevail only for a short time. At  $P_3$  price, demand is large. It is  $P_3F$ . But supply is small. It is only  $P_3E$ . There is excess demand of

EF. Therefore, the price goes up. The buyers try to buy more but the sellers try to sell less. Thus, the price after rising or falling attains the equilibrium position  $OP_1$ .



## MONOPOLY

### *Definition :*

‘Monopoly is a market structure in which there is a single seller, there are no close substitutes for the commodity it produces and there are barriers to entry’.

According to A.J.Braff, “Under pure monopoly there is a single seller in the market.

The monopolists demand is market’s demand. The monopolist is a price maker. Pure.monopoly. suggests a non-substitute situation”.

In simple terms, a monopolist is the sole supplier and potential supplier of the Industry's product. The firm and the industry coincide.

***Characteristics of Monopoly :***

The main features of monopoly as follows :

1. One Seller and a large number of buyers
2. There is an absence of competition.
3. No close substitutes.
4. Cross elasticity of demand for a monopolist's product is zero in case of pure monopoly and very low in the case of simple monopoly.
5. Difficult for new firms to enter.
6. The distinction between firm and industry disappear.
7. Control over the supply of the commodity.

***Types of monopoly***

There are various kinds of monopoly

***1. Natural Monopoly***

A natural monopoly is a special type of monopoly that arises due to economies of scale.

Natural monopolies arise on account of concentration of raw materials in a particular region. An example of natural monopoly is the nickel supply of Canada. Factors like climate, environment and nearness to market, may also create natural monopolies.

***2. Social monopoly :***

Social monopolies are owned and managed by the government. The aim of this monopoly is not profit, but to be of service to the people. Therefore, it is sometimes called welfare monopoly.

Example : Railways, Electricity, Post and Telegraphs etc.

***3. Private Monopoly :***

A private monopoly is owned and operated by a private individual or companies for the consideration of profit. Profit maximisation is the sole objective of such monopolies.

**4. Legal Monopoly :**

Legal monopolies are conferred on certain firms and are protected by law for them to enjoy for some given period of time, the fruits of their labour. The special trade marks, copy rights and patents are the best examples of legal monopoly.

**5. Service Monopoly :**

Monopoly may arise in services also. For example, there is only one doctor in a particular locality who alone can perform the most difficult operation. He is in the position of a monopolist.

**6. Simple Monopoly :**

A simple monopoly is one in which the monopolist will charge the same price for a particular product from all customers.

**7. Fiscal Monopoly :**

Sometimes some activities like minting of coins or printing of currency will be undertaken only by the government for various reasons. Such monopolies are known as fiscal monopolies.

**8. Discriminating Monopoly :**

A discriminating monopoly is one in which different prices are charged for the same product from different customers.

Example : Lawyers charge different rates from different clients.

**9. Voluntary Monopolies :**

Voluntary Monopolies are created to eliminate competition and to reap abnormal profits.



***(a) Cartel :***

A cartel is a group of firms whose objective is to limit the scope of competitive forces in the market. Example : OPEC (the organisation of petroleum exporting countries).

***(b) Trust :***

When all the firms merge into one association, the monopoly is referred to as a trust. The Associated Cement Companies (ACC) in India is an example of a Trust.

***(c) Holding Company :***

A holding company is one which obtains a monopoly position by owing the majority of shares in a company or a group of companies.

***Advantages of Monopoly :***

Following are the advantages of monopoly :

1. Large Scale Production.
2. No economic waste
3. Better bargaining capacity
4. Marketing economies
5. Promotes technology
6. Better treatment of labourers.
7. Avoids wasteful competition.

***Evils of Monopoly :***

Following are the evils of monopoly :

1. Very high price
2. Lower output
3. Exploitation of factors of production
4. Loss of consumer sovereignty.
5. Distribution of Resources
6. Problem to the government
7. Inflation
8. Inequality in wealth
9. Country affected

**Price-Output Determination under Monopoly**

***Assumption :***

The analysis of the determination of the price, output under monopoly is based on the following assumptions.

1. There is only one seller or producer of a homogeneous product.
2. There are no close substitutes for the product.
3. There is pure competition in the factor market so that the price of each input he buys is given to him.
4. The monopolist is a rational being who aims at maximum profit with the minimum of costs.
5. There are many buyers on the demand side but none is in a position to influence the price of the product by his individual actions. Thus, the price of the product is given for the customer.
6. The monopolist does not charge discriminating price. He treats all consumers alike and charges a uniform price for his product.
7. The monopoly price is uncontrolled. there are no restrictions on the power of the monopolist.
8. There is no threat of entry of other firms.

***Price output determination under monopoly :***

Like a perfectly competitive firm, the monopolist tries to maximise his profits. A monopolist will be in equilibrium when he produces that much amount of output which yields maximum total profit. A monopolist is also in equilibrium in short period when he incurs minimum loss. Under monopoly, for the equilibrium and price determination there are two different conditions.

1. Marginal revenue must be equal to - marginal cost
2. MC must cut MR from below.

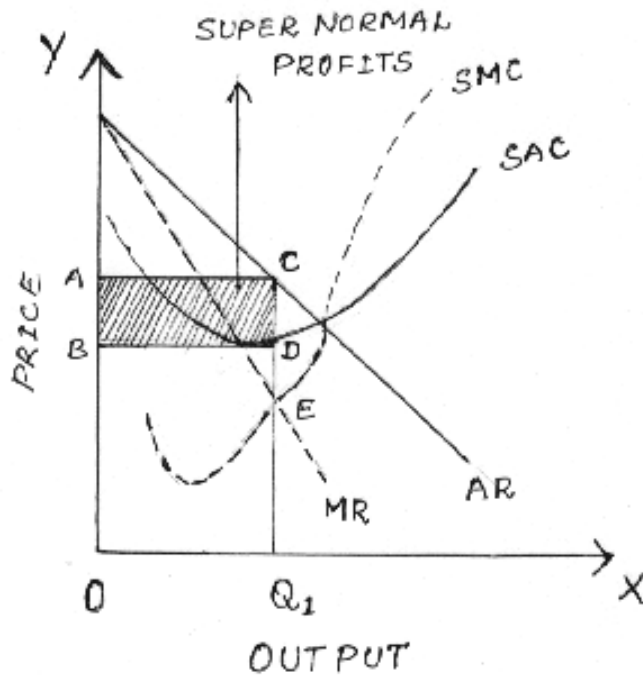
**Short-Run Equilibrium**

***1) Super Normal Profit :***

If the price determined by the monopolist is more than AC, he will get super normal profits, the monopolist will produce upto the level where  $MC=MR$ . This limit will indicate equilibrium output. It is explained in the following diagram.

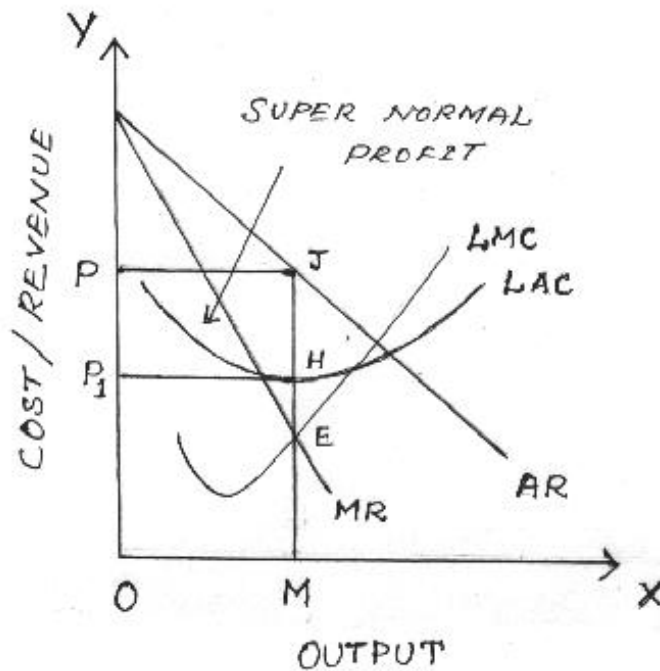
In the above diagram, output is measured on X -axis, and price on Y-axis, SAC and SMC are the short run average cost and Marginal cost curves while AR and

MR are the average revenue and marginal revenue curves respectively. The monopolist is in equilibrium at point E because at point E both the conditions of equilibrium are fulfilled i.e.,  $MR=MC$  and MC intersects the MR curve from below. At this level of equilibrium the monopolist will produce  $OQ_1$  level of output and sells it at  $OQ_1$  by CD per unit. Therefore, in this case total profits of the monopolist will be equal to shaded area ABCD.



## 2) Long-Run Equilibrium :

Long-run is the period in which output can be changed by changing the factors of production. In other words, all factors can be changed and monopolist would choose that plant size which is most appropriate for specific level of output where marginal revenue curve cuts the long-run marginal cost. This can be shown with the help of diagram.



In the above diagram monopolist is in equilibrium at OM level of output. At OM level of output marginal revenue is equal to long run marginal cost and the monopolist fixes OP price. HM is the long run average cost. Price OP being more than LAC i.e., HM Fetch the monopolist super normal profits. Accordingly, the monopolist earns JM-HM = JH Super normal profit per unit. His total super normal profits will be equal to shaded area PJHP<sub>1</sub>.

### ***Comparison between Monopoly and Perfect Competition***

#### ***Similarities***

1. Both are extreme cases of market situations.
2. In both the markets, identical commodities are sold.
3. Profit maximisation is of the same process  $MR=MC$ .
4. Large number of buyers.

***Differences :***

<b><i>Monopoly</i></b>	<b><i>Perfect Competition</i></b>
1. One Firm	Large number of firms
2. Absolute control over supply.	No control over supply
3. The firm is price maker	The firm is price taker
4. Price is higher than marginal revenue.	Price is equal to marginal revenue.
5. Price is higher than marginal cost	Price is equal to marginal cost.
6. No new firms can enter the industry.	New firms can enter freely.
7. Supernormal profits earned in the long-run	Only normal profit is earned in the long-run. also.
8. Differential pricing is possible.	Uniform price.
9. Excess capacity exists.	Optimum Capacity Production.
10. Short-run and long-run equilibrium are the same	Short-run equilibrium is different from long-run equilibrium.

***Discriminating Monopoly***

***Meaning :***

Discriminating monopoly is different from simple monopoly. In simple monopoly, only one price is charged for all the consumers. But sometimes, in order to maximise his revenue, the monopolist can sell the same product at different prices. This is known as Price Discrimination or Differential Pricing.

***Definitions :***

Prof. Watson, "In general, Price discrimination means that a firm charges two or more prices for the same thing at the same time".

In the words of J.S.Bain, "Price discrimination refers strictly to the practice by a seller of simultaneously charging different prices for the same goods".

***Types of Price Discrimination :***

There are different types of price discrimination.

***1. Personal Discrimination :***

Price discrimination is personal when different prices are charged from different buyers on the basis of their ability to pay. For example: a doctor may charge higher fees from a rich patient and charge lower fees from a poor patient for the same services rendered.

### ***2. Use Discrimination :***

A higher price may be charged when a service is used for one purpose and different price for another use. This means that different uses are distinguished and that customers can afford to pay more for one use than the other. ***For example :*** an electric company can charge lower price for electricity supplied to industries and agriculture and higher price for domestic purposes.

### ***3. Place Discrimination :***

It is very common in international trade. The same commodity is sold at higher price in the local market and at a cheaper price in Foreign markets. It is called 'dumping'. The purpose of charging a high price in the home market is to offset the loss incurred by selling the commodity at cheaper price in the foreign markets.

### ***4. Time Discrimination :***

The telephone department charges different rates at different time-high rates during day time and low rates during night time. The railways charge low rates during summer for hill station visitors.

### ***Objectives of Discriminating monopoly :***

1. To take away consumer's surplus
2. To dispose off occasional surplus
3. To develop new market.
4. To make full use of excess capacity.
5. To make maximum monopoly profits.
6. To anticipate and prevent any competition.
7. To increase sales.

### ***Necessary conditions for price Discrimination :***

The monopolists can practice price discrimination only under certain favourable conditions. Successful Price discrimination depends upon the following conditions.

- i) Multiple Demand Elasticities
- ii) Sealed Markets.
- iii) More than one market.
- iv) Imperfect market.

### ***Advantages of Price Discrimination :***

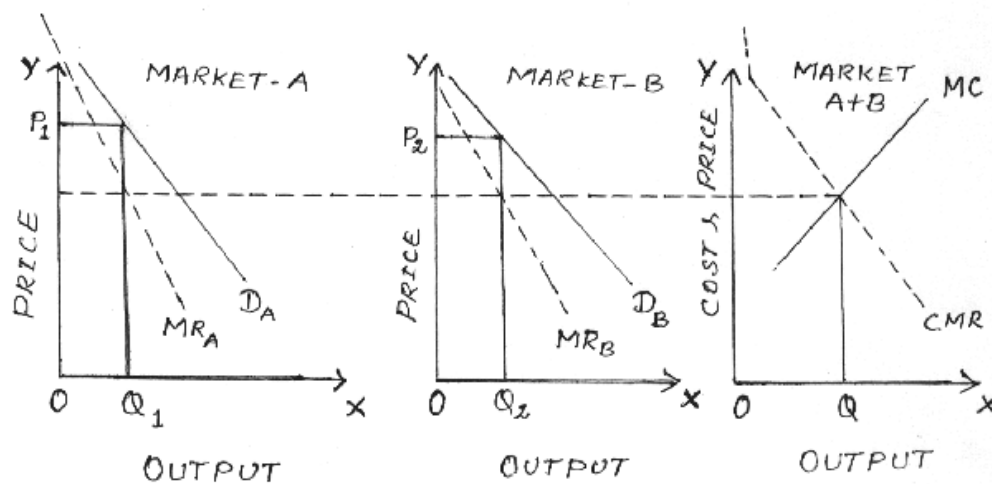
1. Price discrimination promotes more production. Under simple monopoly, the monopolist will sell restricted quantities of commodities at high prices. Under discriminating monopoly, he sells more to more people at low prices.
2. In the larger interests of the people, price discrimination can be justified. In the absence of differential pricing certain services are not available at all.
3. Price discrimination enables a price being charged from every consumer on the basis of his ability to pay and thus meeting the total cost of production.
4. Price discrimination can reduce inequalities of income and wealth in the country.

### ***Equilibrium under Discriminating Monopoly***

A discriminating monopolist like an ordinary monopolist, aims at maximum profits. To achieve this, he has to divide the market on the basis of elasticity of demand. To earn maximum profits, two conditions have to be fulfilled.

1. The marginal revenue in all the markets must be the same.
2. The marginal revenue in all the markets must also be equal to the marginal cost of the entire output of the monopolist.

The Figure below shows price determination under discriminating monopoly.



The Demand curve  $D_A$  in the market A is less elastic while the demand curve in the market B,  $D_B$  is more elastic,  $MR_A$  and  $MR_B$  are the corresponding marginal revenue curves, which adding together, we get the combined marginal revenue curve  $CMR$ . We assume that the product is homogeneous and therefore have a single marginal cost curve for the whole output, irrespective of the market in which it is sold. Hence the monopolist will maximise profits by equating the marginal cost of the whole output with the marginal revenue and produces the total output  $OQ$ . Then he sells his product in the two markets on the basis of the elasticity of demand. In market A, the price is high because the demand is less elastic. In the market B, the price is less as the demand is relatively elastic. Thus the monopolist fixes output and price according to the difference in elasticity of demand and distributes the output in such a way as to maximise profits. As a result, we have,

- i) Total output =  $OQ_1 + OQ_2 = OQ$
- ii)  $OQ_1$  is sold at price  $OP_1$  ;  $OQ$  is sold at price  $OP_2$ .

### ***Monopolistic Competition***

**Definition :** Monopolistic competition may be defined as the market setting in which a large number of sellers sell differentiated products.



Prof. “Edward Chamberlin” of the Harvard university is the architect and builder of the theory of monopolistic competition. He has revolutionised economics theory by developing this concept and explaining the most significant features of such a market situation. Today, we find that a few large business firms produce nearly all the soaps, cigarettes, toothpastes, scooters, etc. None of these companies produces the entire market supply that if one firm should stop production, the others could raise their prices because the total supply would be less.

***Features (Characteristics) :***

***The following are the features of monopolistic competition.***

1. Large sized firms.
2. Product differentiation
3. Selling cost.
4. Free Entry and Exit of firms.
5. Independent Pricing Policy
6. High Cross Elasticity of Demand.

***1) Product Differentiation :***

Product differentiation is one of the most important features of monopolistic competition. Since each seller is interested to sell more of his product, he has to distinguish his products from the others. There are two bases of product differentiation.

First, differentiation of products is based upon certain characteristics of the product itself such as exclusive patented features, trade marks and trade names, peculiarities of packages or differences in quality, design and colour.

Secondly, the differentiation is based upon the conditions surrounding the sale of the product. These conditions include the convenience of the seller's location, his reputation for fair dealing, courtesy and efficiency. Matches, cigarettes, tinned products of various kinds are examples of product differentiation.

## **2) Selling costs :**

The concept of selling costs has revolutionised the theory of value. Prof. Chamberlin, the architect of the theory of monopolistic competition has done a significant contribution to the development of the concept.

### **Meaning :**

All expenses incurred by a firm to boost the sales can be considered as selling costs. They are intended to increase the demand of a particular product.

In the words of prof. chamberlin, “Cost incurred in order to alter the position or the shape of the demand curve for a product”.

### **Examples of Selling Costs :**

All expenses by a firm on propaganda, salesmanship and publicity can be considered as selling costs. Such selling efforts include giving free samples, free service, door-to-door canvassing and display. Selling costs include expenses on advertisements.

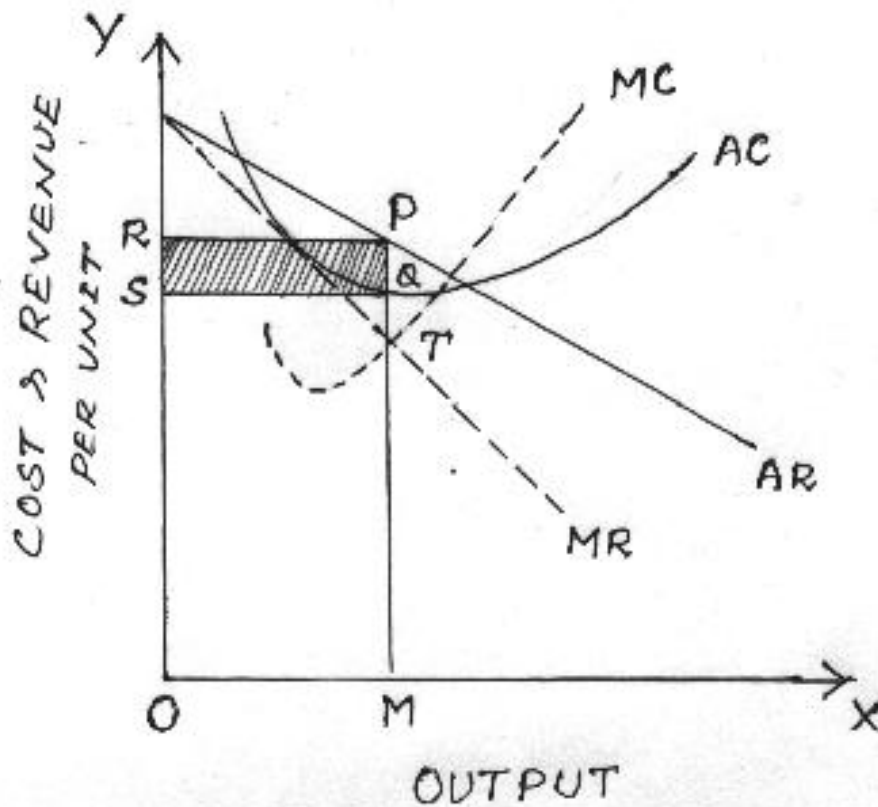
### **Types of selling Costs :**

There are two types of selling costs :

- i) Informative selling costs.
- ii) Manipulative selling costs.

## **PRICE DETERMINATION UNDER MONOPOLLISTIC COMPETITION - SHORT - RUN**

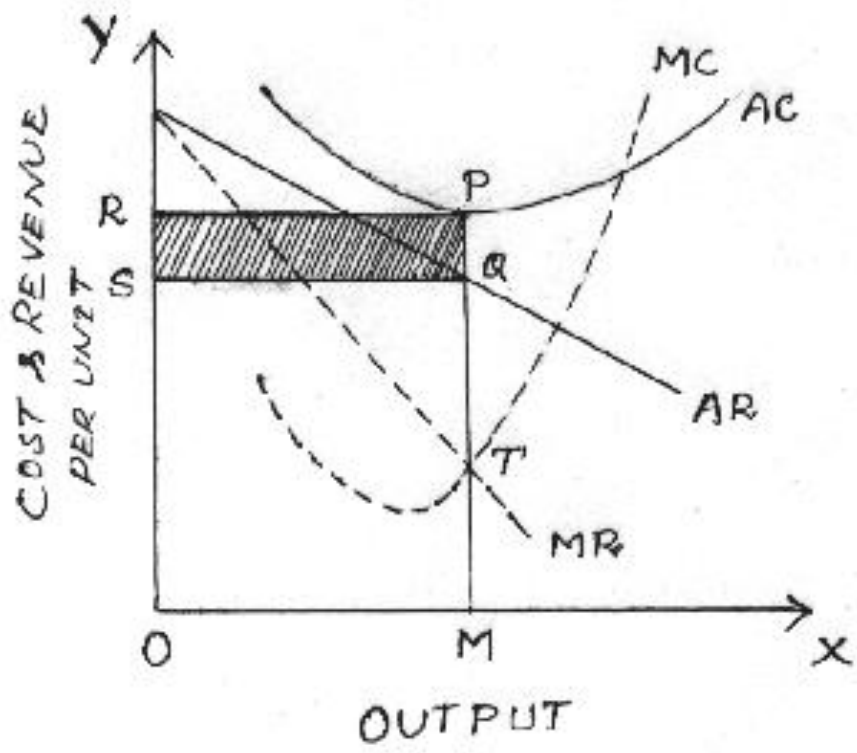
Every Producer, whether he is a pure competitor, monopolist or anywhere between the two, aims at maximising his profits. He will take into consideration his cost and revenue. The maximum profits can be earned at the point where marginal revenue is equal to the marginal cost of production. The firm under monopolistic competition is no exception to this profit maximising formula.



The figure shows a monopolistically competitive firm in equilibrium producing optimum output and making maximum profits at least possible cost.

***Monopolistically competitive firm - Suffering loss***

A firm under monopolistic competition can suffer loss if it has only a very few customers. Under such circumstances the average revenue will be much less than the average cost and the firm will lose. The figure below shows a firm suffering loss.

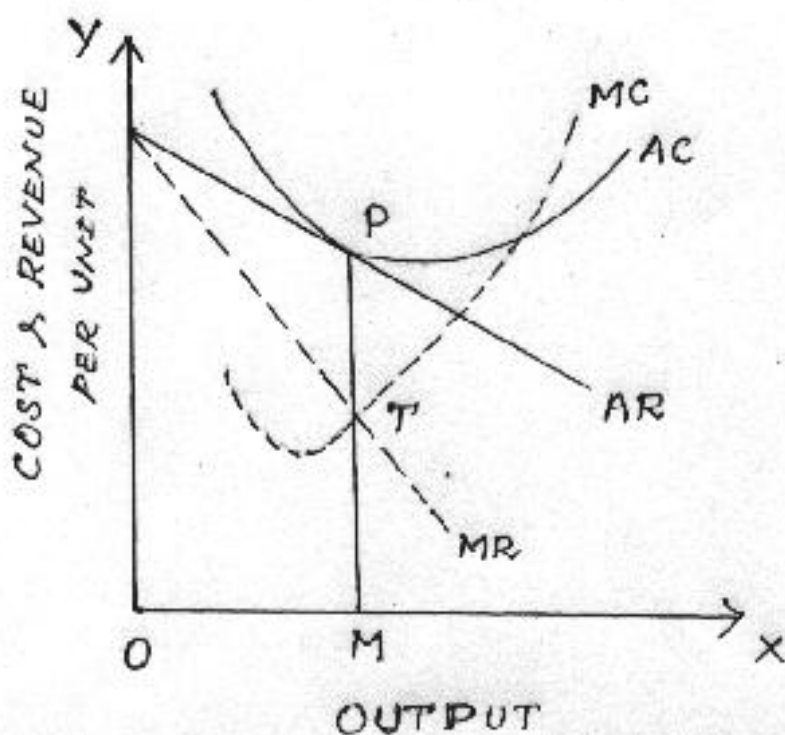


The equilibrium point is T where MC and MR intersect each other. The firm sells OM output at PM price. The costs per unit is also PM. The revenue is P. The average cost curve AC is to the left of average revenue curve AR. The firm suffers a total loss shown by the shaded area PQRS.

**Price Determination under Long-run. “Group Equilibrium”.**

In the long period, the demand and cost curves of the individual firm in the ‘group’ or industry will change their position. The demand for the product of the firm will become more elastic. There are two reasons for this. Firstly, the abnormal profits earned by a few firms in the short period would attract new firms which will fix lower prices than the price charged by the existing firms. Secondly, the new firms may also offer close substitutes for the product which was successfully sold by the existing firms. This would naturally compel the existing firms to reduce price. As a result of such keen competition, price falls.

But then the average cost goes up as a result of demand on factors of production. Gradually, the super normal profits once enjoyed by a few firms in the short run vanish and in the long period normal profit are earned by the firms. The figure below illustrates long-run group equilibrium under monopolistic competition.



The Figure shows the equilibrium position of a firm. It produces OM output and sells at PM price. The average revenue curve AR is tangent to the average cost curve AC at P. The firm is making only normal profit. In other words, super normal or excess profits vanish in the long period.

It must be remembered that disappearance of the excess profits will generally take place and most of the firms will earn only normal profits. This is what takes place when 'heroic assumption' such as identical cost and demand conditions are made. If we relax these assumptions, different firms will have different cost and demand conditions and some firms will make abnormal profits even in the long run despite the entry of new firms with close substitutes. But

such cases are very small and we can say that under long period generally the excess profits vanish and normal profit prevails.

## **OLIGOPOLY**

Oligopoly is competition among a few sellers. The term 'oligopoly' has been derived from the Greek words, 'Oligoi' meaning 'few' and 'Pollein' meaning 'Sellers'. Oligopoly thus means few sellers. It is the most dominant form of market in the present day world.

According to Stigler, Oligopoly is "that situation in which a firm bases its market policy in part on the expected behaviour of a few close rivals".

### ***Types of Oligopoly***

#### ***1. Pure Oligopoly :***

If the products of the firms are homogeneous, it is called pure oligopoly. purchases have little cause for preferring the product of one firm to that of another on any basis except price. Examples: Cooking Gas, Cement, Baby Food etc.

#### ***2. Differentiated Oligopoly :***

Usually, oligopolistic firms sell differentiated products. The products of all the firms are very close substitutes for each other. Example fiat and Ambassador cars, Talcom powder etc. They have high cross elasticity of demand. But each product has its own special features. It is also called Imperfect oligopoly.

#### ***3. Competitive Oligopoly :***

When the firms under oligopoly compete with each other, there is competitive Oligopoly.

It means that there is no mutual understanding between the sellers in their output and price policy.

#### ***4. Collusive Oligopoly :***

When the oligopolistic firm combine together to fix output and prices, there exists collusive, oligopoly.

#### ***5. Partial Oligopoly :***

When the market is dominated by a price leader, it is called partial oligopoly.

#### ***6. Full Oligopoly :***

In an Oligopoly market, where there is no price leader, it is called full oligopoly.

#### ***Features of Oligopoly (Characteristics) :***

Following are the main features of oligopoly :

- (i) Interdependence
- (ii) Uncertainty
- (iii) Selling cost.
- (iv) Price leadership (Dominating price leader and Barometric price leader)
- (v) Price Rigidity.

#### ***Pricing under Oligopoly :***

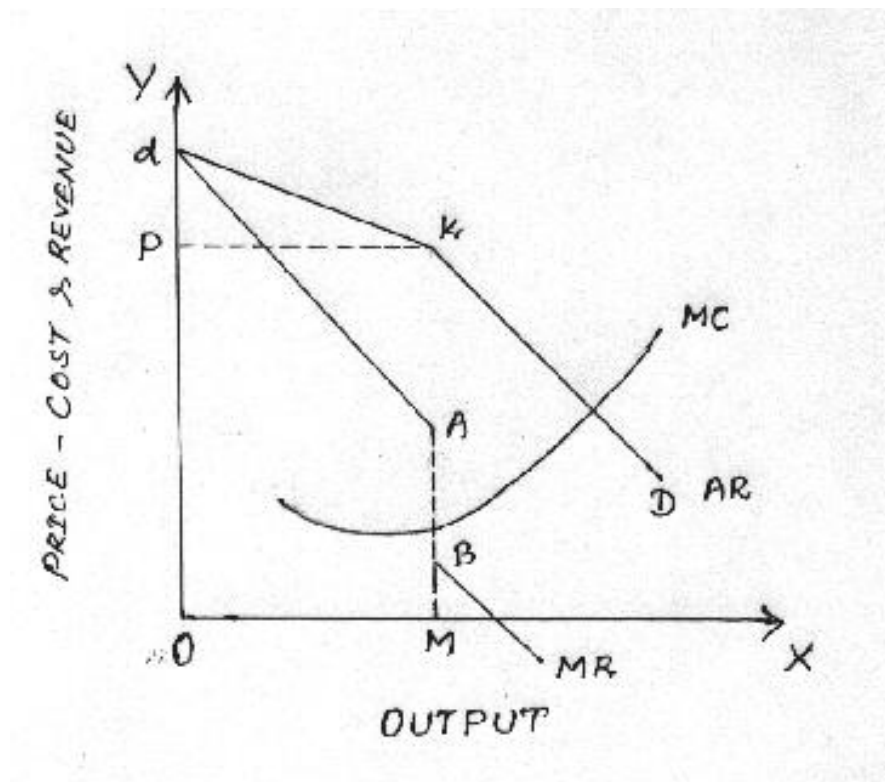
In 1939, Paul Sweezy has introduced the 'kinked demand curve' as an operational tool for the determination of the equilibrium in oligopolistic markets. He has used the kinked demand curve model to explain the phenomenon of 'Price Rigidity' under oligopoly conditions. Price rigidity is a situation when there is no inclination on the part of the sellers to change the price of the products being sold.

The kinked demand curve model of price rigidity is based on the following assumptions :

1. There is an established market price at which all the sellers are satisfied.
2. Each seller's attitude depends on the attitude of his rivals.

3. MC curve passes through the dotted portion of the MR curve so that changes in marginal cost do not affect price and output.
4. An attempt of every seller to push up his sales by reducing the price will be counteracted by other sellers.
5. If the seller raises the price, others will not follow him rather they will stick to the prevailing price.

The following diagram illustrates the kinked demand curve model of price determination under oligopoly.



In the above figure, dKD is the kinked demand curve of an oligopolistic firm; OP is the prevailing market price; and OM is the equilibrium level of output. If an oligopolistic seller (or firm) increases the price of the product above OP, this will reduce his sales because the rivals are not expected to follow his price. This is because the dK portion of the kinked demand curve is elastic and the corresponding dA portion of the MR curve is positive.



On the other hand, if the seller reduces the price of the product below OP, his rivals will also reduce their price. Though he increases his sales, his profits would be less than before. The reason is that kD Portion of the kinked demand curve below OP is less elastic and the corresponding part of MR curve below B is negative.

Thus in both the price-rising and price-reducing situations, the oligopolistic seller will be loser. Therefore he will stick to the prevailing market price OP which remains rigid. Price will be stable so long as the MC curve cuts the MR curve in the dotted portion (AB) of the kinked demand curve.

Thus the oligopoly price OP is determined for the OM level of output at the point of kink K.

The equilibrium of the firm under oligopoly is thus defined by the point of the kink k because any point to the left of the kink, MC is below the MR while to the right of the kink, MC is larger than the MR. Thus the total profit is maximised at the point of the kink K. However, this equilibrium is not necessarily defined by the intersection of the MR and MC curve. So long as MC curve passes through the dotted portion (AB) of the MR curve, the oligopolistic seller maximises his profits by producing and selling OM level of output.

### **IMPERFECT COMPETITION**

Perfect competition and pure monopoly do not exist in the real world. We have only imperfect competition prevailing in the real world. It takes different form such as monopoly, monopolistic competition and oligopoly.

The concept of Imperfect competition was first described by Prof. Piero Sraffa in 1926. Several other eminent economists like Pigou, Robins, Robertson and Kahn contributed to the development of the concept. But the credit of developing the concept to the fullest extent goes to two economists namely, Edward Chamberlin and Joan Robinson. Prof. Chamberlin is the author of the famous book “the theory of Monopolistic Competition” and Joan Robinson is famous by his book “The Economics of Imperfect competition” We may point

out that in 1993 these books were published and before that the classical concept of perfect competition dominated economic theory.

***Features of Imperfect Competition :***

Following are the main features of Imperfect competition.

- i) Small number of firms.
- ii) Differentiated products.
- iii) Control over supply and price.
- iv) High-pressure advertisement.
- v) Absence of knowledge about market conditions.
- vi) Presence of Efficient and Inefficient Firms.
- vii) Transport cost.
- viii) Presence of excess capacity.
- ix) Inferior products
- x) Special services.

***Wastes of Imperfect competition :***

It is pointed out that perfect competition promotes economic welfare through efficient utilisation of resources. Resource application takes place in an ideal manner and the society is supposed to get all the benefits like full employment ideal output, superior goods at cheap price etc. Under Imperfect competition, it is remarked that there are many economic wastes.

1. There is a huge waste of resources in unnecessary advertisement. Firms engage themselves in cut-throat competition which is an economic waste.
2. Firms as already pointed out do not produce the ideal output and stop production before reaching the optimum point. Therefore there is economic waste of resources. The machinery and plant could be utilised fully but purposely, the producer restrict output.
3. As a result of restricted output, the society is penalised by very high prices. It leads to reduction of economic welfare.
4. Enormous amounts are spent 'on' transport cost. It is a waste.

5. Not only the price is higher but the product is also inferior. This is because of the existence of inefficient firms.

All these show that under Imperfect competition there is lot of economic waste.

### **PRICING METHODS**

The following are the major pricing methods :

1. The cost plus or full-cost pricing.
2. Pricing for a rate of return.
3. Marginal cost pricing.
4. Going rate pricing.
5. Customary prices.
6. Differential pricing.

#### ***1. Cost plus or full cost pricing method :***

Full cost pricing is the most common method adopted for pricing. In this method, price is adjusted to cover costs of material, labour and overhead and a pre determined percentage for profit. This percentage differs from firm to firm, industry to industry and even among products of the same firm.

#### ***Advantages :***

1. This method helps in establishing fair and plausible prices.
2. It can be applied by a single product firm or a multi product firm.
3. When the selling price is predetermined, the product design can be determined very easily.
4. In practice, firms are very uncertain about the demand for their product and the

probable response to change in price. This method is then a fool-proof method.

5. It prevents frequent price fluctuations.
6. It may protect the firms' against price wars.

## **2. Pricing for a Rate of Return**

Under this method, price is fixed depending on costs. The price is similar to that of full cost pricing. The only difference is setting the mark up. Under the rate of return pricing method, a price is fixed by a manufacturer so as to give him a fixed return on his investment. Prices are adjusted to changes in costs. With this purpose three popular policies are followed.

- (i) Revise prices to maintain constant percentage mark up over costs.
- (ii) Revise prices to maintain profits as a constant percentage of total sales.
- (iii) Revise prices to keep a constant return on invested capital.

The following formula is used to calculate the desired rate of return on investment.

$$\begin{array}{l} \text{Percentage mark} \quad \text{Capital employed} \\ \text{up on cost} \quad \quad = \frac{\text{-----}}{\text{Total Annual cost}} \times \text{planned rate of return} \end{array}$$

### ***Advantages :***

1. This method is more suitable for products which can be sold in bulk quantity.
2. It is simple method.
3. When the turnover is quick a low rate of return can be fixed and more profits can be obtained.
4. This method will succeed if a firm is able to set and control its price and estimate its sales.

### ***3. Marginal Cost pricing :***

Under this method, prices are fixed on the basis of variable costs. Fixed costs are ignored. Here the firm seeks to maximise its total contribution to fixed costs and profits.

### ***Advantages :***

1. This method is useful for firms to face competition.

2. This method is highly useful for public utility undertaking. In public utility concerns lower prices are charged. This helps to maximise social welfare.
3. Marginal cost pricing is more useful for pricing over the life cycle of a product.
4. Marginal cost reflect future when compared to present cost levels.
5. During the depression period this method is workable.

Marginal cost pricing is more effective than full cost pricing in view of two characteristics of modern business.

- (i) Marginal cost pricing is the most suitable method of short run pricing.
- (ii) Fixed costs and demand conditions may change from one short run to another. Profit will be maximised in the long run only by maximising contribution in each short run.

#### ***4. Going Rate Pricing :***

Under this method, though the firm has the power to fix its own price, instead of doing so it will adjust its own price policy to the general pricing structure prevailing in the industry. This means that the firm does not have a price policy of its own, instead it imitates the price charged by others in the industry.

This method is usually happening in oligopolistic and monopolistic competitive market situations. This method is the least costly and least disruptive to industrial harmony. This method is not confined only to small business firms. Large concerns may even follow a price set by a price leader.

#### ***Advantages :***

1. Where costs are difficult to be measured, the going rate represents the collective wisdom of the industry.
2. Adopting the going rate policy will avoid price war among rival firms. eg. Oligopoly.
3. A firm can be a price maker under this method.

### **5. Customary Prices :**

Under this method, firms accept the price prevailing in the long run. Such prices which last for a long period are called customary prices. Unless costs change sufficiently, customary prices may not change, certain kinds of goods come for sales in customary prices.

Suppose a product is introduced in a new mode. If the firm comes forward to reduce the price, the consumers think that the standard of the product has gone down. Hence in order to remove such wrong feelings, a firm charges only customary price for its products.

We cannot always think that a firm cannot change the customary price. A producer can examine the price policy of rival firms and he can think of customers mind and resort to measures which may change customary prices.

### **6. Dual Pricing :**

Dual pricing is a method of pricing of a product under which the product may have two prices. One is the controlled price fixed by the government. Another one is the market price. Usually determined on the basis of cost of production and a reasonable margin of profit.

The controlled price is generally lower than the market price in cases where the purpose is to protect the interests of the poor and the weaker sections of the society. The controlled price may also be higher than the market price in cases where the purpose is to protect domestic industries against foreign competition.

Pricing of sugar and cement in India is a good example of dual pricing. Dual pricing is thus a price control or price regulation system.

### **7. Differential Pricing :**

Differential pricing means charging different prices for different customers for the same product. This is actually price discrimination. This is applicable to monopoly pricing. Even if there is no monopoly, differential pricing is possible. Due to wide disparities in income, differential pricing is possible. This is due to

difference in elasticity of demand. As a result higher prices can be charged for richer consumers and lower prices for poorer consumers.

The producer has different goals in adopting differential pricing.

- i) To reach a particular sector of the market through price differentials.
- ii) To achieve profitable market segmentation.
- iii) To encourage new user or to attract new customers.
- iv) To adjust to competitive situations.
- v) To allow seasonal discounts and to achieve reduction of production cost.

### ***8. Recommended Pricing.***

Recommended prices are normally treated as maximum prices, both by retailers as well as consumers. Retailers sometimes overstep recommended prices. The consumer is also reluctant to pay a higher price because an average consumer considers the printed price as the maximum one.

Recent studies indicate that recommended prices are welcomed by retailers. If the recommended price is fixed at a low level, it will act as a disincentive to retailers to stock the product because they will fail to earn even their normal profit. On the other hand, fixing a high recommended price gives an opportunity to the retailers to offer a great price reduction to consumers. But unfortunately this might no doubt create in the mind of the consumers about the quality of the product if price reductions are frequently made.

### ***9. Administered Pricing :***

Administered prices are prices fixed by the government normally on the basis of cost plus a stipulated margin of profit. Commodities sold at the fair price shops under the public distribution system are also subject to administered prices.

### ***10. Pricing over the life cycle of a product :***

No product can have distinctiveness over the entire life period. After a certain time, the distinctiveness of a product starts declining, At the last stage of a product's life, the whole distinctive character is lost and the product becomes a

common commodity. The innovation of a new product and its degeneration into a common product is known as “Life cycle of a product”. There are five distinct stages in the life cycle of a product.

***(i) Introduction :***

At this stage, the product enters the market. People have no knowledge of the new product.

***ii) Growth :***

In this stage, the product is pushed in the market with quick demands and sales. If consumers are satisfied, the firms earns increased profits.

***iii) Maturity :***

In this stage its growth continues but with declining rate. The number of consumers go down.

***iv) Saturation :***

Sales reach the highest point. There is little additional demand.

***v) Decline :***

The sales come down due to better substitutes in the market.

The life cycle may be renewed. For that cycle to take shape, the following favourable

conditions must emerge :

- i) Discovery of new user for products
- ii) The coming in of new uses for the product.
- iii) Introduction of new features.

### **III. PROMOTION**

Promotion is a form of communication with an additional element of persuasion to accept ideas, products, services and hence persuasive communication becomes the heart of promotion, the third element of marketing mix. In essence, promotion is the spark plug of our marketing mix and an important marketing strategy. People must know that the right product at



the right price is available at the right place. It is said that in a competitive market without promotion nothing can be sold.

### **1) What is Promotion ?**

Promotion is the process of marketing communication to inform, persuade, remind and influence consumers in favour of our product or service. Promotion has three specific purposes. It communicates marketing information to consumers, users and resellers. Promotion persuades and convinces the buyer and influences his/her behaviour to take the desired action. Promotion has been defined as “the co-ordinated self-initiated efforts to establish channels of information and persuasion to facilitate or foster the sale of goods or services, or the acceptance of ideas or points of view”. It is a form of non-price competition. Promotion is persuasive communication to inform customers of the existence of products to persuade and convince them that those products have want satisfying capabilities.

The promotion mix includes four ingredients, namely 1. advertising, 2. publicity, 3. personal selling, and 4. all forms of sales promotion.

**1. Advertising :** It is defined as any paid form of non-personal presentation and promotion of ideas, goods and services by an identified sponsor. It is impersonal salesmanship for mass selling, a means of mass communication.

**2. Publicity :** It is non-personal stimulation of demand for a product, service or a business unit by placing commercially significant news about it in a publication or obtaining favourable presentation of it upon radio, television, or stage that is not paid for by the sponsor.

**3. Personal Selling :** It is the best means of oral and face-to-face communication and presentation with the prospect for the purpose of making sales. There may be one prospect or a number of prospects in the personal conversation.

**4. Sales Promotion :** It covers those marketing activities other than advertising, publicity and personal selling that stimulate consumer purchasing and dealer effectiveness. Such activities are displays, shows, exhibitions, demonstrations,

and many other non-routine selling efforts at the point of purchase. Sales promotion tries to complement the other means of promotion given below.

All kinds of promotion play the role of communication channels between the marketer and the consumer. Promotion as an element of marketing mix has three broad objectives: (a) information, (b) persuasion, (c) reminding. The overall objective of promotion is, influencing the buyer behaviour and his predispositions (needs, attitudes, goals, beliefs values and preferences).

Four promotion mix elements have a definite role in all stages of the selling process. Publicity is more effective in the awareness stage. Advertising gradually becomes less and less effective. Personal selling becomes more and more effective as interpersonal interaction assumes increasing importance.

Today, promotion is not regarded as the sole tool of marketing communications. We have now the wider concept of the term 'marketing communication'.

Thus, all 4 ps, (product, price, promotion and place of distribution) communicate and act as senders of marketing messages.

## ***2) The Process of Communication in Marketing :***

There are three essential parts of communication, namely, the source, message and receiver.

Marketing communication involves sharing of meaning, information, and concepts by the source and the receiver about products and services and about the firm selling them. Marketing communication is undertaken by marketers through the devices of promotion. namely, advertising, publicity, salesmanship and sales promotion.

The effective communication occurs when a sender (source) sends a message and a receiver responds to the message in a manner which satisfies the sender. Both must have identical meaning of the message.

Effective communication is equal to: receipt of the message plus understanding plus acceptance plus action. In marketing action means decision to purchase.

In marketing management, the source or communicator is the marketer who desires to promote his product. He attempts to deliver a message to a receiver. He can deliver the message in many ways. All forms of promotion are media or channels of communicating or sending the message. The receiver or audience is the target market segment. i.e., the group of consumers for whom the message is sent. Message is received and interpreted by consumers and if their predispositions become favourable, they decide to purchase. Feedback is the reverse flow of communication from the consumer to the marketer.

When the message is transmitted through personal salesmanship, the seller may have prompt feedback from the receiver. The sender can find out how the message is being received as we have face-to-face direct communication through sales talk and conversation.

### ***3) Main Purpose of Promotion :***

The overall purpose of promotion is to influence buyer behaviour and alter the location and shape of the consumer demand curve in favour of the products. All promotional efforts, i.e., marketing communications are directed to alter the demand curve or buyer behaviour.

### ***4. The Promotion Process (Persuasive Communication)***

The hierarchy of behavioural effects on the consumer decision-making process has these stages as : 1. awareness, 2. knowledge, 3. liking, 4. preference, 5. conviction, and 6. action.

Promotion is a systematic attempt to move forward step by step prospects from a stage of unawareness to awareness, then to knowledge and liking, then to preference and conviction and finally to action (purchase) or a positive behavioural response.

We can think of three distinct kinds of consumer response to promotion :

1. awareness and knowledge emphasizing cognitive response 2. changes attitudes, emphasizing affective response. 3. new behaviour indicating motivational response.

**5) Promotion Strategy :**

When marketers resort to promotion or persuasive communication in marketing, we have a kind of the promotion square. It has four sides of equal importance, namely 1. The product described in the marketing communication. 2. The prospect to be converted into a customer through persuasion and influence by promotion. 3. The seller or the sponsor who undertakes promotion, and 4. The channel or the route along which the product will move from marketer to buyer.

Product

Buyer

Promotion  
Square

Company

Channel

The promotion strategy will depend upon these four sides. The promotion strategy deals with the following decisions : 1. the blend of promotional activities (advertising, publicity, personal selling and sales promotion). 2. the amount allocated for the various forms of promotion particularly to the advertising media such as press, radio, television, and so on, 3. the kind of promotion to be used. The interdependencies of all kinds of promotion demand an integrated approach to promotion mix.

**i) The Product :** The product is one of the factors determining the form of promotion. Toys, Toilet Soaps and Cosmetics are effectively shown on television.

**ii) The Buyer :** If the marketers are to provide realistic solutions to the problem of buyers, they must know their customers their needs and desires, their attitudes, values, aspirations and expectations.

*iii) The Company :* The firm has a unique public image in the market. The firm's image must be closely associated with promotional strategy so that its goodwill can be exploited. Corporate advertisements usually emphasize more on the character, reputation, reliability and responsibility of the marketing firm.

*iv) The Channel Choice :* The promotional strategy also depends on the channel or route through which products of the firm flow to consumers. There are pull and push strategies in promotion.

#### **6) Promotion Decisions :**

Once the marketing plan is ready we can develop a total promotion programme to approach the target audiences. Budget for each element of promotion is prepared.

Promotion objectives must be set before we decide on message contents, layout and delivery of message. Contents and layout decisions are based on strengths and weaknesses of the various media vehicles. Delivery decisions are based on the needs of carrying particular types of messages. Promotion objectives, message design, message delivery and promotion budget are the constituents of promotion programme. All these are highly inter-related decisions areas.

## **IV SALES PROMOTION**

Sales promotion is an important instrument in marketing to lubricate the marketing efforts. Today, sales promotion is a necessity and not merely a luxury or a fashion. It is not an expenditure; it is an investment which can pay rich dividends. It is an integral part of the marketing effort.

### **1) What is Sales Promotion ?**

Sales promotion is referred to the promotional activities other than personal salesmanship, advertising and publicity which stimulate consumer purchasing and dealer effectiveness e.g. displays, exhibitions and showrooms, demonstration, coupon, premium, contests are the non current selling efforts not

in the ordinary routine. Sales promotion is a bridge covering the gap between advertising and personal selling, the two wings of sales promotion is a bridge covering the gap between advertising and personal selling, the two wings of sales promotion.

**2. Sales promotion objectives :** 1. to increase buying responses by ultimate consumers.

2. to increase selling efforts and intensity by dealers as well as by sales personnel. 3. to supplement and co-ordinate efforts of Advertising / Personal Selling.

**3. Forms of Sales Promotion :** 1. calling attention to new products and product improvements, 2. informing buyers of new brand and new package 3. Improving customer patronage and brand loyalty, 4. obtaining dealer outlets, 5. securing additional shelf-space and added display, 6. creating talking points for sale persons, 7. meeting competition. 8. Improving market share.

**4) Strengths of Sales Promotion : (Advantages)**

1. It stimulates positive attitudes toward the product. 2. It gives extra incentive to the customer to make a purchase. 3. It gives direct inducement to take immediate action now rather than later. 4. It has flexibility and it can be used at any stage of a new product introduction.

**5) Limitations of Sales Promotion :**

1. Sales promotion have temporary and short life not exceeding three months. Sales promotion along cannot build up brand loyalty. 2. Sales promotions are only supplementary devices to supplement selling efforts of other promotion tools. 3. They are non-recurring in their use. They have seldom reuse values. 4) Advertising agencies accord low status to sales promotion. 5. Too many sales promotion may affect brand image.

**6) Kinds of Sales Promotion :**

There are two kinds of sales promotion. i) Consumer Sales Promotion ii) Dealer Sales Promotion

**1) Consumer Sales Promotion :** These devices are : 1. Sampling, usually called consumer sampling. Free samples are given to consumers to introduce a new product or to expand the market. The consumers can try the product. 2. Demonstrations or instructions educating the consumers in the manner of using the product. 3. A coupon is a certificate that reduces price.

**a) The Quiz/Contest Craze :**

The basic strategy in contests is to provide an extra-incentive to the consumer for buying a product.

Contests are used to reach short-term sales goals. If properly designed, they can achieve other objectives as well.

### ***Publicity / Public Relations***

***I. Publicity :***

Publicity is also called marketing public relations. Publicity is not paid for by the organisation. Publicity comes from news reporters, columnists and journalist people. It comes to the receiver as the truth rather than as a commercial. Public relations and publicity taken together become the fourth major ingredient of promotion mix. These activities are, however, not controllable by the firm. Every firm tries to create a good public relations so as to give good publicity.

Under the social marketing concept, publicity and public relations are assuming unique importance in the firm's promotion mix.

***II. Public Relations :***

Public relations have now become an important marketing function. The total process of building goodwill towards business enterprises and securing a bright public image of the company is called public relations. It creates a favourable atmosphere for conducting business. There are 4 groups of public

i) customers ii) share holders  
 iii) workers iv) the community. The marketers should have the best possible relation with these groups. Public relations complement advertising by creating product and service credibility. Effecting marketing communication is not possible without establishing and maintaining mutual understanding between the company and its customers. The lubricant making the wheel of marketing is public relations. Bright image is created and maintained only by public relations. Liberal aid in all social welfare projects enhances the public image of the marketer.

**III. Marketing Communication Process :**

1. It presents a set of messages to a target market through numerous media.
2. The message try to create a favourable response from the market (with the help of unique sales propositions) towards the company's total product offering.
3. The company tries to get back adequate feedback the consumers which points out their response.
4. The feedback enables the company to improve and modify its total product offering.

**5. Elements of Marketing Communication :** 1. Sender of the message also called the communicator, 2. message in the form of commercial ideas, sales story, advertising copy, package print and label etc., 3. channel or media, the vehicle carrying the message, a sales person an advertisement, sales literature, phone, television, radio, press etc.,

4. receiver a prospect, customer, reseller, purchase influencer, the audience or destination, 5. feedback in the form of a response, reaction, counter-proposal called feed back from the receiver to sender. Feedback improves the effectiveness of communication. 6. noise or obstacles reducing the effectiveness of communication process.

6. The company is not only the source or sender of market messages but also a receiver of market responses.



7. As a sender of messages, the company communicates with the market not only through promotional tools but also through product, price and place or point of sale (the retail store) as well.

8. Market responses are collected by the company through marketing research / information system.

9. All the four 'Ps' of the marketing-mix are now recognised as components of company's communication mix. Promotion is the vital means of communication.

## V. PERSONAL SELLING

Personal selling refers to oral face to face interaction or conversation between a sales representative and prospective customer for the purpose of making sales. Personal selling is more effective in the trial stage of the purchase process.

Pederson and Wright suggest that salesmanship is "the process whereby the seller ascertains and activates the need or wants of the buyer and satisfies these needs or wants to the mutual, continuous advantage of both the buyer and seller". This definition of salesmanship is customer-oriented. Personal selling is a two-way rather than one-way communication.

**1) Features of Salesmanship - (Personal selling):**

**1. High Pressure Salesmanship :** Growth of consumerism and emergence of buyer's market also indicate that high pressure salesmanship has outlived its utility.

**2. Salesmanship is Persuasion :** Salesmanship involves the ability to influence or persuade people. It is the skill in handling people which makes for a successful salesman.

**3. Salesmanship is Winning the Buyer's Confidence :** Modern salesmanship does not use doubtful methods of influencing buyer. Modern salesmanship aims at winning the confidence of the buyer by providing a solution to the buyer's problem, by persuading him and educating him.

**4. Salesmanship Aims at Providing Service to the Buyer :** Salesmanship aims at serving the customer, by using the knowledge and ability to provide the best available solution to the buyer's problem.

**5. Salesmanship Aims at Mutual Benefit :** Salesmanship helps him in obtaining the maximum return for the money he spends. It enables the producer to produce more, to increase his sales and his profits.

**6. Salesmanship is an Education Process :** Salesmanship educates people about their needs.

**7. Salesmanship is a Creative Process :** Salesmanship is responsible for creation of demand (not through a problem-solving approach. It starts with customer knowledge. It studies customer needs and problems through customer's viewpoint.

### **2) The Modern Concept of Salesmanship**

The modern concept of salesmanship, on the other hand, is based on the idea of service. Modern salesmanship is creative in approach. The modern salesmanship tries to create need, awareness of these needs and uses resourcefulness and imagination to persuade customers. It uses the problem-solving approach to ensure customer satisfaction.

### **3) Types of Salesman :**

There are three fields of salesmanship

1. Industrial salesmanship, 2. Merchant salesmanship, and 3. Consumer salesmanship.

#### **1. Industrial Salesmanship (Business Marketing) :**

Industrial salesmanship may need a technical background in engineering or chemistry to understand the problem and know the language of technically trained purchasing agents. Industrial salesman may represent manufacturers or wholesalers or agents.

## **2. Merchant Salesmanship (Wholesale Selling) :**

Merchant salesmanship involves quantity selling of all types of customer goods (convenience, shopping and specialty goods) to resellers. They operate in the consumer goods market as well as in industrial goods market. The customers of merchant salesman are : 1. Wholesalers, 2. Distributors, 3. Retailers, 4. Co-operatives, Institutions, and

6. Industrial buyers. They operate mainly in the resale market. Merchant salesman also operate in the service markets for selling services (eg) advertising communication. The merchant salesman acts a salesman of manufactures selling direct to wholesalers or distributors and merchandise to numerous dealers and retailers.

We have four varieties of merchant salesman : i) Speciality salesman ii) Missionary salesman, iii) Creative salesman, and iv) Detail salesman.

**(i) Speciality Salesman :** He is called upon to sell consumer specialities, such as vacuum cleaners, refrigerators, cosmetics, books, etc., as well as business goods, such as industrial products, material supplies etc.

**(ii) Missionary Salesman :** Missionary salesman are responsible for promoting sales and creation of demand. They help merchants in arranging store displays, planning store sales.

**(iii) Creative Salesman :** He is a salesman who seeks to introduce a new product or a new brand into the the market and create a demand for such a novelty. He is a pioneering salesman. He cultivates and develops sales territories. He is responsible for a lot of spadework before a product is accepted by common consumers.

**(iv) Detail Salesman :** Detailign is a form of specialty selling. The detail salesman visit doctors, dentists, architects, engineers to sell them on recommending a product to their clients. Medical representatives of drug manufacturing companies are detail salesman.

3) **Consumer Salesmanship** (Retail Sale) : While advertising attracts prospective buyers to the retail store, the sale depends upon counter salesman of the store. The retail salesman helps the customer to take purchase decision, to buy here.

There are three types of outside (outdoor) consumer salesman. The route salesman who follows a regular route serving consumers e.g., baked goods or laundry. The independent consumer salesman sells on his own account e.g., street vendors, pedlars, mobile retailers.

**4) Advantage of Salesmanship :**

1. A salesman can pinpoint prospect, whereas advertising cannot distinguish precisely a prospect from a suspect. Hence there is minimum waste of effort and expenditure in personal selling.
2. Personal interview in salesmanship assures attention and interest of a prospect, Personal selling has flexibility.
- 3) Salesman can adjust sales presentation on the spot to meet objections and reactions of his prospect in order to gain action.
- 4) Actual demonstration of the product or its use is recognised as the most powerful means of convincing. Advertising (except TV Ads) cannot use demonstration. But salesman can use it easily.
- 5) personal selling is the best means of two-way communication continuously between the company and its customers.

**5) Limitation on Salesmanship :**

- 1) The greatest limitation is the high cost of personal selling particularly in inflationary conditions. The cost of developing and maintaining efficient salesforce is quite high.
- 2) Good and competent sales-persons are scarce. Sales profession is becoming less attractive.

### **6) A-I-D-A-S Formula :**

The salesman, in order to effect a sale, must persuade the customer to buy his product. This act of persuasion needs proper planning of the strategy and tactics. The customer must be taken through certain stages of the mind. These stages are very effectively summarised by what is known as the A-I-D-A-S formula.

1. 'A' Attention
2. 'I' Interest
3. 'D' Desire
4. 'A' Action
5. 'S' Satisfaction

## **VI ADVERTISING**

### **1) What is Advertising ?**

Advertising is a form of mass communication. It is paid for by a sponsor (seller) who wants to communicate about his product or service to his customers. The advertiser or sponsor wants to persuade and induce the readers, viewers or listeners to take some action, namely to buy the advertised product so that the advertiser can have profitable sales.

Advertising can be defined as mass, paid communication (presentation and promotion) of goods, services or ideas by an identified sponsor. It is paid communication because the advertiser has to pay for space or time in which his advertisements appear. Advertising appears in the recognised media, such as newspapers, magazines, radio, television, cinema film, outdoor boardings and posters, direct mail and transit (car cards).

**2) Advantages of Advertising :** Advertising is a major promotion tool. It has the following basic plus points or strengths as a promotion tool. 1) It offers planned and controlled message. 2. It can contact and influence numerous people simultaneously, quickly, and at a low cost per prospect. Hence, it is called mass means of communication. 3. It has the ability to deliver messages to audiences

with particular demographic and socio-economic features. 4. It can deliver the same message consistently in a variety of contexts. 5. It can reach prospects that cannot be approached by salesmen, e.g., top executives. 6. It helps to presell goods and pull the buyers to retailers. 8. It is very useful to create maximum interest and offer adequate knowledge of the new product when the innovation is being introduced in the market.

### ***3) Weaknesses of Advertising as a Promotion Tool :***

1. It is much less effective than personal selling and sales promotion at later stages in the buying process. 2. It is less flexible than personal communication. It cannot answer objections raised by prospects. 3. It is essentially one way means of communication. 4. It is most efficient communication (very low cost per prospect) but it is least effective as a tool of communication. 5. It is unable to reach prospects when they are in a buying mood. Hence, we have to repeat advertisements and repetition involves additional cost. 6. Advertising media, e.g., newspapers, magazines, carry many messages competing to secure attention of audience simultaneously. Thus, it creates noise in communication. 7. Advertising, many a time, lacks credibility and trustworthiness.

### ***4) Distinguishing Features of Advertising :***

1. It is a unique means of non-personal or mass communication announcing the sale of goods or services. It can help to introduce a new product quickly.
2. The advertising is non-personal salesmanship performing similar functions like personal salesmanship. It is a silent but forceful salesmanship. It helps to presell a product.
3. It is an openly sponsored sales message regarding any product or service, i.e., the sponsor can be identified.
4. It is a paid communication - paid for by the sponsor (advertiser) to the media owner (seller of advertising space or time).

5. Advertising message can be addressed to numerous persons at a time - they may be readers, listeners, viewers, collectively called audience of advertisement. It has the ability to expose large groups of prospects at a low cost per prospect.

**5) Differences between advertisement and salesmanship :**

1. Salesmanship is personal involving direct personal face-to-face communication. Advertising is non-personal and indirect means of communication with the prospect through various media of advertisement.
2. Salesmanship is individual (person-to-person) communication through personal interview between their salesperson and the prospect. On the other hand, advertising is mass communication, advertiser reaching a large number of prospects simultaneously. An advertisement is read, seen or heard by any number of prospects.

Similarly, there are two differences between advertising and other forms of publicity.

1. Advertising must be carried on by an identified sponsor. Publicity need not have identified sponsor.
2. Advertising is a paid form of communication. Publicity is not a paid form of communication. In a sense, paid publicity is advertising.

**6) Importance of Advertising in Marketing :**

In the marketing programme of a business, advertising is an indispensable tool supplemented by salesmanship and sales promotion.

Advertising by facilitating mass production and mass distribution has provided immense employment opportunities to people. It is responsible for creating and delivering rising standard of living to innumerable people. It has made possible tremendous industrialisation and economic development in many countries. It is the backbone of modern national and international marketing.

**7) Advertising Purposes :**

Advertising purposes and tasks are set by marketing plans and strategies. Advertising is the use of paid for, sponsor-identified material in mass media

(including direct mail). The real purpose of advertising is only one, namely to sell something - a product, a service, or merely an idea through effective communication. Most advertising attempts to simulate sales to all customers (present, former and future). Advertising has other purposes as well. It is used to reassure buyers that they have really made the best purchase. Thus, advertising can build up brand loyalty. Advertising can enhance the morale of the salespeople and dealers thereby securing enthusiastic distribution of products. Advertising is also employed to promote the bright image of the firm in the society.

#### **8) Advertising as Communication Process :**

The following four criteria describes communications process as applied to advertising. We have : 1. communicator. 2. idea 3. media. and 4. audience in the process of communications.

Advertising goals may be divided into four stages of commercial communication as follows:

**1. Awareness :** The prospect must become aware of the existence of the brand or company. Awareness is the bare minimum goal of advertising.

**2. Comprehension :** The prospect must understand what the product is and what it will do for him. Comprehension level indicates that people are not only aware of the brand or company but they also know the brand name and can recognise the package or trademark. But they are not convinced that want to buy.

**3. Conviction :** The prospect must be mentally convinced to buy the brand or the product. The conviction level shows brand preference and intention to buy the product in the near future.

**4. Action :** The prospect takes meaningful action. Purchase decision is duly taken.



### **9) Advertising Campaign :**

A campaign is a series of operations to achieve a goal. A single idea or theme is the centre of our efforts. All promotional efforts are directed towards pre-set goal, namely, maximum sales and service.

## **VII. CHANNELS OF DISTRIBUTION - I**

In the field of marketing, channels of distribution indicate routes or pathways through which goods and services flow, or move from producers to consumers.

The distribution channel as the set of inter dependent marketing institutions participating in the marketing activities involved in the movement or the flow of goods or services from the primary producer to the ultimate consumer.

The total distribution system which is responsible for distribution of goods or services in order to satisfy consumer needs or desires.

### ***Meaning and Definitions of Channels of Distribution***

**William J. Stanton** has defined a trade channel in these words - “A channel of distribution (sometimes called a trade channel) for a product is the route taken by the title to the goods as they move from the producer to the ultimate customer or industrial users”

### ***Functions of Channels of Distribution***

- |                                 |                               |
|---------------------------------|-------------------------------|
| 1. Help in Production Function. | 2. Matching Demand and Supply |
| 3. Financing the Producer       | 4. Aid in Communication       |
| 5. Stabilising the Prices       | 6. Promotional Activities     |
| 7. Routinisation of Decisions   | 8. Pricing.                   |

### ***Factors Affecting the Choice of Channel of Distribution***

The channel choice are influenced by several factors. They are

#### ***1) Product Characteristics :***

The product characteristic play an important role in influencing the channel selection. They may be

- i) Purchase Frequency
- ii) Perishability
- iii) Selling Price per Unit
- iv) Standardised Products

#### ***2) Market Factors or Consumer Factors :***

The following market features influence the channel decision. They are

- i) Consumer or Industrial Market
- ii) Number of Purchasers
- iii) Geographical Distribution
- iv) Size of Orders
- v) Customers' Buying Habits

#### ***3) Company or Enterprise Factors :***

The choice of channel is also influenced by company characteristics such as its financial position, size, product, mix, morale of its employees, past channel experience and executive prejudices and overall marketing policies.

- i) Financial Resources
- ii) Size of the Company
- iii) product mix
- iv) marketing policies
- v) Attitude of company executives

#### ***4) Middlemen Considerations :***

The choice of channel also depends upon the strengths and weakness of various types of middlemen performing various functions such as

- i) Services Provided by Middleman
- ii) Attitude of Middlemen
- iii) Cost of Channel Usage
- iv) Sales volume potential

### **5) *Environmental Factors***

The environmental factors such as economic, ethical and social conditions and law of the land also influence the channel decision.

#### **1) *Role of Channels of Distribution :***

These channels perform the following marketing functions in the machinery of distribution:

1. The searching out of buyers and sellers (contacting).
2. Matching goods to the requirements of the market (merchandising).
3. Offering products in the form of assortments or packages of items usable and acceptable by the consumers/users.
4. Persuading and influencing the prospective buyers to favour a certain product and its maker (personal selling/sales promotion).
5. Implementing pricing strategies in such a manner that would be acceptable to the buyers and ensure effective distribution

6) Providing feedback information, marketing intelligence and sales forecasting services for their regions to their suppliers.

7) offering credit to retailers and consumers.

8) offering pre and after sales service to customers.

#### **2) *Sub-divisions of Distribution System :***

Distribution system has two sub-divisions : 1. Channels of distribution, 2. Physical distribution. The channel members such as mercantile agents, wholesalers and retailers are middlemen in distribution and they perform all marketing functions.

Physical distribution looks after physical handling of goods, and assures maximum customer service. It aims at offering delivery of right goods at the right time and place to customers. Physical distribution activities cover: 1. Order processing; 2. handling of goods, 3. Packaging, 4. Warehousing, 5. Transportation, 6. Inventory control, and 7. Customer service.

### **5) Middlemen in Distribution :**

There are two types of middlemen in distribution: 1. Merchant middlemen buy and sell goods on their own account and at their own risk of loss, e.g. wholesaler and retailer. 2. Agent middlemen who do not take ownership title to goods but actively negotiate the transfer of ownership right from the seller to the buyer. e.g., selling commission agent or broker.

### **6) Channel System**

Under the systems approach the channel is now recognised as a system involving flow of : 1. information, 2. Marketing communications (promotion), 3. materials, 4. man power, 5. capital equipment, and money.

### **7) Channels of Distribution :**

Some important channels of distribution are hereunder :

**1. Manufacture - Consumer- Channel (Direct Sale) :** There are three alternatives in direct sale to consumers; (a) sale through advertising and direct methods (mail order selling), (b) Sale through travelling sales force (house to house canvassing). (c) Sale through retail shops of manufactures. e.g., mills cloth shops, (Bata Shoe Company Shops).

**2. Manufacture - Retailer - Ultimate Consumer :** This channel option is preferable when buyers are large retailers, e.g., a department store, discount house, chain stores, supermarket, big mail order house or co-operative stores. The wholesaler can be by-passed in this trade route.

**3. Manufacture - Wholesaler - Retailer - Consumer :** This is a normal, regular and popular channel option used in groceries, drugs, drug goods, etc. It is suitable for a producer under the given conditions : (a) He has a narrow product line. (b) He has limited finance. (c) Wholesalers are specialised and can provide strong promotional support.

**4. Manufacture - Agent - Wholesaler - Retailer - Consumer :** In this channel the producer uses the service of an agent middlemen such as a sole selling agent, for the initial dispersion of goods. The agent in turn may distribute to

wholesalers, who in turn sell to retailers. Many textile mills have sole agents for distribution.

**5. *Manufacture - Wholesaler - Consumer/User*** : Wholesaler may pass retailer when there are large and institutional buyers. e.g. business houses, Government, hospitals etc.

### **8 *Channel Choice (Channel Alternative)***

Marketing channel decisions considerably influence all other marketing decisions such as pricing and promotion. Channel decisions also require special attention as these involve long-term commitments to other firms with whom marketer enters into a contract.

The most fundamental factor for channel choice and channel management is economic criteria, namely, cost and profit criteria. Profit organisations are primarily interested in cost minimisation in distribution and assurance of reasonable profit margin. However, channel decisions are not made entirely on the basis of rational economic analysis.

The following are other critical factors.

**1. *Product*** : (a) If a commodity is perishable or fragile, a producer prefers few and controlled levels of distribution. For perishable goods speedy movement needs shorter channel or route of distribution. (b) For durable and standardised goods longer and diversified channel may be necessary. (c) For custom made product direct distribution to consumer or industrial user may be desirable. (d) Products of high unit value are sold directly by traveling sales force and not through middlemen.

**2) *Market*** : (a) For consumer market, retailer is essential, whereas in business market we can eliminate retailer. (b) If the market size is large, we have many channels, whereas in a small market direct selling may be profitable. (c) Size and average frequency of customer's orders also influence the channel decision. In the sale of food products, we need both wholesaler and retailer.

**3. Middlemen :** (a) Middlemen who can provide wanted marketing services will be given first preference. They must accept marketing policies and programmes of the manufactures and actively help them in their implementation.

**4. Company :** (a) The company's size determines the size of the market, the size of its larger accounts and its ability to get middlemen's co-operation. A big firm may have shorter channel. (b) The company's product mix influences the pattern of channels. The broader the product line, the shorter will be channel. If the product mix has greater depth or specialisation, the company can favour selective or exclusive dealerships. (c) A company with substantial financial resources need not rely too much on the middlemen and can afford to reduce the levels of distribution. A weaker company has to depend on middlemen to secure financial and warehousing relief's. Thus quantity and quality of marketing services provided by the company can influence the channel choice directly.

**5. Marketing Environment :** Marketing environment can also influence the channel decision.

During recession or depreciation, shorter and cheaper channel is always preferable. In times of prosperity we have a wider choice of channel alternatives.

**6. Competitors :** Marketers closely watch the channels used by rivals. Sometimes marketers deliberately avoid customary channels (dominated by rivals) and adopt different channel strategy.

#### **9) Channel Decision :**

The first problem of channel design is weather you want direct sale to consumer or indirect sale. i.e., sale through middlemen. Under the direct sale the channel problems become problems in company operations as most of the system's components are parts of the company organisation. If the firm choose the indirect route, it must consider such problems as the type and number of middlemen and the methods to be employed in motivating and controlling them. The selection of these middlemen begins with the knowledge of ultimate

customers - his needs and desires for distribution services. The number of middlemen employed will be determined by customer conveniences and economics of exclusive distribution. The company must choose whether to attempt extensive, selective or exclusive distribution or combination of all the three types. The decision is made after a careful analysis of product, consumers, dealers, company objectives and policies, and the conflict within the channels and bring the product profitably to the market.

1. Each channel of distribution is responsible to perform the typical marketing functions assigned to exclusively. 2. Retailing, wholesaling and physical distribution (transport, storage and inventory control) are treated as separate entities in distribution for purposes of easier understanding.

3. Locating customers, serving their demand and offering them service and satisfaction are the basic tasks of the manufacturers, wholesalers and retailers who combine to form an integrated channel of distribution.

#### ***10) Market Coverage :***

Once the company decides the general channel to be used it has to decide on the number of middlemen in each channel :

There are four alternatives.

***1. External Distribution :*** Extensive or broad cast distribution is essential when the price is low, buying is frequent and brand switching is a common phenomenon. Extensive distribution secures rising sales volume, wider consumer recognition and considerable impulse purchasing. But it creates problem of motivation and control and it may generate unprofitable sales due to higher marketing costs.

***2. Selective or Limited Distribution :*** When special services are needed, e.g. TV sets or a right prestige image is to be created, e.g. certain cosmetics to be sold only through chemists, we have selective distribution. When we have limited number of middlemen, they can spend more on sales promotion and offer maximum cooperation in the company's promotion campaign.

**3. Exclusive Distribution :** When final buyers do not need any product service, mass or extensive distribution is adopted. If the amount of product service expected by final buyers is considerable, exclusive distribution is preferable.

***There are three major aspects of exclusive distribution :***

**i) Exclusive Dealing Contracts :** They prohibit the dealer from selling products or rivals.

**ii) Trying Contracts :** They compel the dealer to carry full line of a manufacture.

**iii) Closed Sales Territory :** It limits each dealer to sell only to buyers located within the assigned area.

**4) Franchise Selling :** Franchise means a privilege or exceptional right granted to a person. Franchise selling is a term to describe in effect selective or exclusive distribution policies. Franchise selling any contract under which independent retailers or wholesalers are organised to act in close cooperation with each other or with manufacturers to distribute given products or services. Franchise selling is a system under which a manufacturer grants to certain dealers the right to sell his product or service, in generally defined areas, in exchange for a promise to promote and sell the product in a specific manner. The franchiser (the parent company) provides equipment, the products or services for sale, and also managerial services to franchisee (the owner of business unit)

Under this system, the owner of the product issues a licence to independent dealers in certain areas and encourages them to make profit for themselves. The owner retains control over the technique or style with which the goods or services are sold.

***We have three forms of franchising :***

i) The manufacturer-sponsored retail franchise system (eg) car maker licenses dealers to sell its cars.



ii) The manufacturer-sponsored wholesaler franchise system. (eg) coca-cola licenses bottlers.

iii) The service - firm-sponsored retailer franchise system. For example, Fast-food-service, auto-rental business, motel business.

### ***ii) Physical Distribution - II***

#### ***What is physical distribution ?***

The marketing process is not complete simply by creating a superb product and by creating a customer by aggressive salesmanship. Delivering the product to the customer at the right time and place is equally important function in marketing. In the process of marketing this vital function is called physical Distribution. Physical Distribution means the process of delivering the product to the user or consumer promptly, safely and in time.

Physical Distribution involves management of the physical flows of raw material, finished goods from the points of origin to the points of use or consumption to meet the customer needs at a profit. It covers all activities in the flow of goods between producer and consumer.

#### ***Components of physical Distribution :***

- 1) Distribution planning and accounting.
- 2) In bound transport
- 3) Receiving
- 4) Inventory management
- 5) In-plant warehousing
- 6) order processing
- 7) packaging
- 8) Dispatch of goods
- 9) outbound transport
- 10) Field warehousing
- 11) Customer service
- 12) Communication.

Physical distribution components or activities can be used as element of marketing strategy

Thus physical distribution management has assumed, great importance as it can reduce the cost of transport, storage, material handling, order processing and holding inventories.

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## UNIT V

### SERVICE MARKETING APPLICATIONS

#### **Objectives of the study:**

The objectives of this unit are to help one understand, in general, the:

- Importance of Service Marketing in the Finance field:
- Role played by the different fund based and non-fund based Financial Services products, namely, Leasing, Hire Purchase Services, Consumer Finance, Insurance, Factoring, Mutual Funds, and Credit Cards.

#### **Contents Design:**

- 5.1. Introduction
- 5.2. Marketing retention strategies of some fund and non-fund based financial services
- 5.3. Leasing
- 5.4. Hire purchase services

5.5. Consumer Finance

5.6. Insurance

5.7. Factoring

5.8. Mutual funds

5.9. Credit cards

## **5.1. INTRODUCTION**

Marketing identified goods and services. But the growing importance of services have been identified and felt only very recently, leading to the slow emergence of services as the most indispensable part of all business activities. Services, once considered as the supplementary business activity of marketing goods, now reached a stage where its importance has been clearly identified and cost assigned.

According to the American Marketing Association, Services are: activities, benefits or satisfactions offered for sale; or provided in connection with the sale of goods.

There has been a growing regular market for the services rendered. These services may be: skilled services, semi-skilled services and unskilled services. Skilled services are those rendered as consultancy with practically no physical exertion, such like the Professional Consultants of the higher order. Semi-skilled services are those rendered with equal amount of physical exertion as well as consultancy, such like: Practicing Doctors, Chartered Accountants etc. Skilled services are those where the physical exertion is the most, such like those rendered by the on site labourers.

From the year 1960 onwards, there has been phenomenal growth in the service sector, with varied and wide varieties of services. It was evident from when the concept of buyers market was advented and where marketing of goods can not be made in isolation unless and until it is solidly supported by services. Some of the notable services are: Catering services provided by Hotels and Restaurants, Personal care services provided by Beauty Parlours; Communication services

from Telephone and Postal companies including Couriers; Consultancy services provided by Doctors, Engineers, Lawyers; Financial services provided by Banks as well as Non-Banking Financial Institutions; and the like. The reasons for these evidential growths in the service markets are many. Some of them are:

1. There is a lot of money in circulation in the economy and also with the people;
2. There is varying demands and needs of the consumers which they want to satisfy in different ways;
3. There is constant increase in sophistication and complexity in the needs.

However, it is to be noted that the following unique features relating to the service marketers make them more complex and challengeable. They are;

- Intangible nature;
- Perishable nature;
- Heterogeneity;
- Non-acceptability of having a uniform price policy;
- Difficulty in comparing and assessing the quality of services rendered;
- Changes in the pattern of demand;
- Difficulty in demarking individuals from the services they render; and
- Difficulty in quantifying the service received or rendered.

In the present scenario; service marketing becomes a complicated and complex phenomenon which needs a detailed study mainly on two major thrust areas, namely, the different applications of service marketing; and also the knowing the different strategies with which the established market can be retained.

The present unit is a concerted effort in making one study and understand some of the special fund and non-fund based financial services, namely : Leasing and Hire purchase services; Consumer finance; Insurance and Factoring; Mutual funds and Credit cards.

## **5.2. MARKETING RETENTION STRATEGIES OF SOME SPECIAL FUND AND NON-FUND BASED FINANCIAL SERVICES.**

Corporate sector financial requirements range from long term to medium term. In order to satisfy their long term requirements, corporate go to the primary and secondary securities market. However, for meeting their medium term requirements and also the uncovered or under-covered portion of their long term requirements, leads to the emergence of financial services.

Financial services means and include not only providing the required funds of the corporate but also rendering finance related fee based advises or providing both. Financial services may be classified into the following which in no way can be put in water tight categories namely,

1. Asset / Fund based Financial Services;
2. Fee based financial services. and
3. Asset / Fund and Fee based financial services.

Under the Fund / Asset based financial services, the service provider provides the required amount of finances in terms of money or in terms of assets or in both the terms. Lease financing, Hire Purchase financing, Bills discounting, are some of the examples under this category.

Under the fee based financial services, the services provider provides only expert / consultancy services, without taking any risk, for a nominal fee. Here, the responsibility of the services provider is very much limited. Credit rating, Credit cards, is some of the examples for this category.

Under the Asset / Fund and fee based financial services, the service provider provides the funds as well as the assets in accordance with the requirements of the corporate, but at the sometimes charges a nominal sum as fee for the services and expert advises .Factoring, Insurance, Venture capital financing, Stock broking are some of the examples for this category.

In the competitive marketing environment of today, even the service providers find it very difficult to survive in the market. This is mainly because of the following factors, namely,

1. There is large flow of money in the economy.
2. There is a large number of service providers, entering and exiting.
3. There is no major regulatory mechanisms in operations, to control and minimize the risks prevalent in the sector,
4. There is constant changes in the economic, political and social regiments resulting in drastic changes becoming effective in the sector
5. The service requirements of the service demanders are also varied, complex and changing. and
6. Heterogeneity prevails in most dealings.

To have a retainable market, it is imperative on the part of the service provider to look into various marketing retention strategies. In order to achieve this, a detailed knowledge about the various financial services is needed. The present chapter unit is a step in this direction.

### **5.3. LEASING**

#### **5.3.1. Definition**

The Transfer of Property Act defines a lease as a transaction in which a party owning the asset provides the asset for use over a certain period of time to another for consideration either in the form of periodic rent and/or in the form of down payment.

Lease may also be defined as a contract between two parties for the hire of a specific asset wherein the lessor retains ownership of the asset while the lessee has possession and use of the asset on payment of a specified rental over a period of time.

Leasing is suitable for financing the investments in productive equipments and is available to a broad range of business and other service organizations like: hospitals, educational institutions, associations and government as well as non-government agencies.

### **5.3.2. Parties to Lease agreements:**

#### **5.3.2.1. Lessee:**

Lessees vary widely from the one-person operations to the Fortune Hundred corporations where diverse equipments are being leased. Transactions range from a few thousands worth of equipment (such as fax machines) to crores worth cogeneration facilities, telecommunications systems, medical equipment (including CAT scanners and MRI imaging), office systems, computers, commercial aircraft, and transportation fleets. There is no end to the types of equipments that companies lease.

##### **5.3.2.1.1. Obligations of Lessee**

The rights and obligations of a lessee in a lease contract are many and varied.

Some of them are:

- To use the assets during the lease period in accordance to the terms and conditions of the lease agreement.
- To put to proper use, operation, maintenance and storage of the equipment under lease.
- To remit periodically the lease rentals as per the lease agreement.
- To insure at all times and for an amount equal to the full insurable value of the asset.
- To return to the lessor the leased asset on the expiration or earlier termination of the Lease agreement, i.e., in the event of default by the lessee.

#### **5.3.2.2. Lessor:**

Lessor in most cases, are corporate only. There are four basic types of such companies:

- Banks or bank-affiliated firms;

- Captive leasing companies such as subsidiaries of equipment manufacturers who lease out their parent's products;
- Independent leasing companies, which may be small and specialized or large and diversified;
- Others, including those investment bankers and independent brokers/packagegers who bring the parties of a lease together;

#### **5.3.2.2.1. Rights and Obligations of Lessor:**

The rights and obligations of a lessor in a lease contract are;

- Right of ownership of the leased asset.
- Right to claim depreciation on the asset.
- Right to ensure that the asset is put to fair use and within the limitations contained in the agreement.
- Right to collect the rentals and other sums payable by the lessee under agreement.
- Right to sue in case of breach of agreement or any acts of the lessee which ultra vires the agreement.

#### **5.3.3. Types of Lease:**

The following are the different types of Lease agreements.

**5.3.3.1. Operating lease:** Here the lease period is shorter than the expected useful life of the equipment. Rental payments do not cover the equipment cost of the lessor during the initial lease term. This type of lease is popular for high-tech equipment, because shorter term leases help equipment users stay ahead of equipment obsolescence. The lessor uses its equipment with remarketing expertise to subsequently find other users for the returned equipment, something the typical equipment user does not have time or ability to do.

**5.3.3.2. Finance lease:** Here the lease period is longer, more nearly covering the useful life of the equipment. Rentals tend to be lower because of the longer term and less residual value risk.



#### **5.3.3.3. Sale-leaseback:**

One who purchases the equipment has the need and uses it for a period of time before selling it to a lessor. After selling the equipment, one then lease the equipment. This is another way to free up ones operating capital. On smaller equipment leases worth thousands of rupees, leases tend to be more standardized. Above that cost range - several hundred thousand into the millions - variations appear more frequently.

#### **5.3.3.4. Leveraged lease:**

Under this lease, bigger acquisitions are made, such as acquiring an airplane. This may include several customized provisions and options that would not appear in a typical lease for a smaller amount, thus leading to flexibility in the product size of the lease.

#### **5.3.3.5. Short Term Lease:**

These leases are typically for assets that have high depreciation eligibility like computers, windmills etc. They are for a period of 2-3 years, and may be useful to corporate having capital requirements for products that have high obsolescence, high taxable income in the near future.

#### **5.3.3.6. Long Term Lease:**

These are for assets that have low depreciation eligibility like plant and machinery, cars, furniture and fixtures etc. and have a long economic life. Corporate who are interested in leveraging the balance sheet and have a higher operational profit prefer this one.

#### **5.3.3.7. Sub – Lease**

A transaction in which the leased property is re-leased by the original lessee to a third party and the lease agreement between the two original parties remains the same.

#### **5.3.3.8. Secondary Lease**

A second lease period obtained and during which the lessee will pay nominal rentals in order to ensure that the lease period is long enough for the lessee to gain maximum benefit from the lease.

#### **5.3.3.9. Structured Lease**

Structured rentals are not flat or equated over the lease term i.e. the rentals vary over the lease term. The rental structure typically fit the lessee's inflows from the asset. A structured lease will have some visible pattern. The main types of structured leases are as follows:

##### **(a). Stepped-up Rentals:**

The rentals are structured in such a way that the lessee will pay smaller rental amounts at the beginning of the lease period and larger rental amounts towards the end of the lease period i.e. the rentals will increase in proportion over the rental period so that the rentals are heavier towards the end of the lease period.

##### **(b). Stepped-down Rentals:**

The rentals are structured in such a way that the lessee will pay larger rental amounts at the beginning of the lease period and lower rental amounts towards the end of the lease period i.e. the rentals will decrease in proportion over the rental period so that the rentals are heavier at the beginning of the lease period.

#### **5.3.4. Factors determining Lease:**

As the lessee, the following factors determine the most effective type of lease for the company. These factors include: the life of the equipment; what one intend to do with the equipment at the end of the lease; one's tax situation; one's cash flow; and the company's specific needs as they relate to future growth.

Further, one's needs also determine what happens at the end of the lease. As a lessee, one's options include: returning the equipment to the lessor; purchasing the equipment at fair market value or at a nominal fixed price; or renewing the lease.

### **5.3.5. Working of the Lease:**

Almost any type of equipment can be leased. As the lessee, who deal with the lessor concerning the term of and the rate of the lease, ancillary expenses - such as taxes, service, insurance and maintenance, usually are the responsibility of the lessee and are not deductible from the rental payment. There are three ways one can acquire equipment through leasing.

1. One can select and order the equipment and then seek financing through a lessor.
2. One can select the equipment by working with a vendor or a manufacturer who offers leasing through their own subsidiary.
3. One can obtain the equipment directly through a lessor.

In most cases, the lessee selects and orders the equipment before contacting the lessor. Unless provided for in the lease agreement, the lessor doesn't normally provide equipment warranties which are between the lessee and the manufacturer.

By signing the lease, the lessee assigns its purchase rights to the lessor, who already owns or who then buys the equipment as specified by the lessee. When the equipment is delivered, the lessee formally accepts it and makes sure it meets all specifications. The lessor pays for the equipment, and the lease takes effect.

### **5.3.6. Merits of Leasing:**

The following are the merits of leasing. They are:

1. **It is flexible:** Companies have different needs, different cash flow patterns, and different yet irregular - streams of income. For example, start-up companies typically are characterized by little cash and limited debt lines. Mature companies might have other needs: to keep debt lines free, to comply with debt covenants, and to avoid committing to equipment that may quickly become obsolete. Therefore, business conditions - cash flow, specific equipment needs, and tax situation - may

help define the terms of lease. Moreover, a lease provides the use of equipment for specific periods of time at fixed rental payments. Therefore, leasing allows flexibility in the management of equipment.

2. **It is practical:** By leasing, one transfers the uncertainties and risks of equipment ownership to the lessor, which allows one to concentrate on the productive part of the business.
3. **It is cost effective:** Equipment is costly and some of the costs are unexpected. When one lease, risk of getting caught with obsolete equipment is lower because one can upgrade or add equipment to best meet one's needs. Further, equipment needs can change over time due to changes in the company policy, such as diversification. Sophisticated business managers have learned that the primary benefits of higher productivity and profit come from the use of equipment, not owning it.
4. **It has tax advantages:** Rather than deal with depreciation schedules and Alternative Minimum Tax (AMT) problems, the lessee, simply make the lease payment and deduct it as a business expense, thus saving a lot in tax. The lessor can pass on part of the tax benefits to the lessee through reduced rentals.
5. **It helps conserve operating capital.** Leasing keeps lines of credit open, and one need not tie up one's cash in equity. Also, one can avoid costly down payments leading to increased operating capital.
6. It frees working capital for more productive use.
7. It provides 100% funding as opposed to other sources of capital that usually provide only 60-70 percent.
8. It is simple to negotiate and administer.
9. Most expenses associated with the leased equipment can be incorporated into the lease and amortized over the lease period.

### **5.3.7. Hire Purchase Vs Lease**

The economic substance of a lease is similar to that of a HP. A lease is a simple contract of bailment while a hire-purchase has an additional element - an option to buy. There are, however, some differences that affect the choice between a lease and a HP. They are:

#### **1. Tax consequences:**

The depreciation rate does not have any impact on the post tax returns in the case of a HP whereas a lease would be directly affected by it. Higher the depreciation rate, higher the post tax rate of returns. Therefore, lease becomes advisable for items of higher depreciation.

#### **2. Repayment Period:**

Leasing is preferred for periods of 6 years or more while Hire Purchases are undertaken for shorter periods of time.

#### **3. Impact of point of initiation:**

Under the flat method of accounting, HP is a preferred option all over the year. Under the capital recovery method, leasing is the preferred option in the 5th, 6th, 11th and 12th month of the fiscal year.

### **5.3.8. Accounting in the lessor's books:**

- a. Effect as per the Accounting Standard 19
  - The lessor should recognise assets given under a finance lease as a receivable at an amount equal to the net investment in the lease.
  - The lease payment receivable is treated as a repayment of principal.
- b. Effect as per Books of Accounts
  - The lessor will not capitalize the asset on his balance sheet.
  - The Lessor does not depreciate the assets in his books of accounts.
  - He will show the lease receivables as a current asset.
  - The lessor's income statement is credited every year with the interest element of the lease rentals.

c. Effect as per Income Tax Act

- The lease rentals are taken as the lessor's income under "Profits and Gains of Business and Profession".
- Depreciation is allowed to the lessor.

**5.3.9. Accounting in the lessee's books:**

**a. Effect as per Books of Accounts**

- The assets will be capitalized under the "Fixed Assets" category in Balance Sheet. (as per AS 19)
- The Future Lease Rentals payable will be shown in the Liabilities side of the Balance Sheet.
- The Lessee will be entitled to depreciate the assets in the books of accounts.
- The Lessee will be entitled to claim the entire lease rentals as expenditure in the Profit & Loss Account.

**b. Effect as per Income Tax Act**

- The Lease rentals paid during the current year can be written of as an expense in the Profit & Loss Account.

**5.3.10. Activities**

1. Meet the leasing company in your area and know from them what type of lease they have been undertaking with special features.

**Type**

**Features**

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2. Meet the know lessees in your area and enquire about the circumstance which lead to leasing.

**Lessees**

**Circumstances**

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### **5.3.11. Self Assessment Test:**

1. What is leasing?
2. Who is a Lessor? What are his rights & obligations?
3. Who is a Lessee? What are his rights and obligations?
4. Name and explain any four different types of Leasing?

### **5.3.12. Glossary: Bargain Purchase Option**

A lease provision allowing the lessee, at its option, to purchase the equipment for a price predetermined at lease inception that is substantially lower than the expected fair market value at the date the option can be exercised.

Big-Ticket A market segment dominated by leveraged leases and represented by lease financings over \$2 million. Broker A company or person who arranges transactions between lessees and lessors, for a brokerage. Capital Lease Type of lease classified and accounted for by a lessee as a purchase and by the lessor as a sale or financing, if it meets any one of the following criteria: (a) the lessor transfers ownership to the lessee at the end of the lease term; (b) the lease contains an option to purchase the asset at a bargain price; (c) the lease term is equal to 75 percent or more of the estimated economic life of the property (exceptions for used property leased toward the end of its useful life); or (d) the present value of minimum lease rental payments is equal to 90 percent or more of the fair market value of the leased asset less related investment tax credits retained by the lessor.

Certificate of acceptance (Delivery and Acceptance)

A document whereby the lessee acknowledges that the equipment to be leased has been delivered, is acceptable, and has been manufactured or constructed according to specifications.

#### Direct Financing Lease (Direct Lease)

A non-leveraged lease by a lessor (not a manufacturer or dealer) in which the lease meets any of the definitional criteria of a capital lease, plus certain additional criteria.

#### Economic Life (Useful Life)

The period of time during which an asset will have economic value and be usable.

#### Effective Lease Rate

The effective rate (to the lessee) of cash flows resulting from a lease transaction. To compare this rate with a loan interest rate, a company must include in the cash flows any effect the transactions have on tax liabilities.

#### Equity Participant

**The owner participant, thrust owner, or grantor owner.**

#### Equipment Schedule

A document that describes in detail the equipments leased. It may also state the lease term, commencement date, repayment schedule and location of the equipment.

#### Fair Market Purchase Option

An option to purchase leased property at the end of the lease term at its prevailing fair market value. The lessor does not have the ability to retain title to the equipment if the lessee chooses to exercise the purchase option.

#### Finance Lease

Typically, a finance lease is a full-payout, non-cancelable agreement, in which the lessee is responsible for maintenance, taxes, and insurance.

#### Full Payout Lease



A lease in which the lessor recovers, through the lease payments, all costs incurred in the lease plus an acceptable rate of return, without any reliance upon the leased equipment's future residual value.

**Hell-or-High-Water Clause**

A clause in a lease that reiterates the unconditional obligation of the lessee to pay rent for the entire term of the lease, regardless of any event affecting the equipment or any change in the circumstances of the lessee.

**Indemnity Clause**

**A clause in which the lessee indemnifies the lessor from loss of tax benefits.**

**Indenture of Trust (Indenture)**

An agreement between the owner trustee and the indenture trustee. The owner trustee mortgages the equipment and assigns the lease and rental payments under the lease as security for amounts due to the lenders.

**Lease**

A contract in which one party conveys the use of an asset to another party for a specific period of time at a predetermined rate.

**Lease Rate (Rental Payment)**

The periodic rental payment to a lessor for the use of assets. Others may define lease rate as the implicit interest rate in minimum lease payments.

**Lessee**

The user of the leased equipment.

**Lessor**

The party to a lease agreement who has legal or tax title to the equipment, grants the lessee the right to use the equipment for the lease term, and is entitled to the rentals.

**Leveraged Lease**

The lessor provides an equity portion (usually 20 to 40 percent) of the equipment cost and lenders provide the balance on a non-recourse debt basis. The lessor receives the tax benefits of ownership.

Master Lease

**A contract where the lessee leases currently needed assets and is able to acquire other assets under the same basic terms and conditions without negotiating a new contract.**

Middle Market

**A market segment generally represented by financings under \$2 million and dominated by single investor leases.**

Net Lease

**A lease wherein payments to the lessor do not include insurance and maintenance, which are paid separately by the lessee.**

Non-recourse Lease

**In a leveraged lease, the lenders cannot look to the lessor for repayment. The lender's only recourse is to the lessee and, therefore, the lessee's credit rating is of prime importance.**

Open-End Lease

**A conditional sale lease in which the lessee guarantees that the lessor will realize a minimum value from the sale of the asset at the end of the lease.**

Operating Lease

**Any lease that is not a capital lease. These are generally used for short term leases of equipment. The lessee can acquire the use of equipment for just a fraction of the useful life of the asset. Additional services such as maintenance and insurance may be provided by the lessor.**

Packager

**The leasing company, investment banker, or broker who arranges a leveraged lease.**

**Present Value The current equivalent of payments or a stream of payments to be received at various times in the future. The present value will vary with the discount interest factor applied to future payments.**

Residual Value

**The value of an asset at the conclusion of a lease.**

Sale-Leaseback

**An arrangement whereby equipment is purchased by a lessor from the company owning and using it. The lessor then becomes the owner and leases it back to the original owner, who continues to use the equipment.**

Sales-Type Lease

**A lease by a lessor who is the manufacturer or dealer, in which the lease meets the definitional criteria of a capital lease or direct financing lease.**

Single Investor Lease

**A tax-oriented lease whereby the lessor achieves its desired rate of return via a combination of the rental payments, depreciation, and the fair market value of the equipment at the end of the original lease term. Because of the value of the tax benefit, the rental payments will be lower than for a finance lease.**

Tax Lease

**A lease wherein the lessor recognizes the tax incentives provided by the tax laws for investment and ownership of equipment. Generally, the lease rate factor on tax leases is reduced to reflect the lessor's recognition of this tax incentive.**

Trac Lease

A tax-oriented lease of motor vehicles or trailers that contains a terminal rental adjustment clause and otherwise complies with the requirements of the tax laws.

True Lease

**A type of transaction that qualifies as a lease under the Internal Revenue Code. It allows the lessor to claim ownership and the lessee to claim rental payments as tax deductions.**

Trustee

**A bank or trust company that holds title to or a security interest in leased property for the benefit of the lessee, lessor, and/or creditors of the lessor. A leveraged lease often has two trustees: an owner trustee and an indenture trustee.**

Vendor Leasing

A working relationship between a financing source and a vendor to provide financing to stimulate the vendor's sales. The financing source offers leases or conditional sales contracts to the vendor's customers. The vendor leasing firm substitutes as the captive finance company of a manufacturer or distributor through the extension of leasing to customers, provisions of credit checking, and performance of collections and operational administration. Also known as lease asset servicing or vendor programs.

**Foreclosure:**

A foreclosure is the termination of the lease period by the lessor on request of the lessee prior to the end of the lease period

**Lease Management Fee:**

A Lease Management Fee is an upfront, non-refundable fee payable to the Leasing Company for services rendered like processing / marketing etc.

**Residual value:**

The value of the equipment at the conclusion of the lease term is called the residual value. It is the value at which the assets are transferred from the lessee to the lessor.

## **5.4. HIRE PURCHASE SERVICES**

### **5.4.1. Meaning and Characteristics:**

The Hire purchase Act defines a hire purchase as a type of installment credit under which the hire purchaser (hirer) agrees to take goods on hire of a stated rental with an option to purchase.

A commercial hire purchase (CHP) is a particular type of finance used by businesses for the purpose of purchasing a new or used vehicle or other business equipment.

In general, a Hire Purchase agreement is regarded as a financing arrangement in which the principal purpose is to finance the use of a piece of equipment for the majority of its useful life. Under this agreement, the Hirer chooses the type of equipment, the supplier, the make, model and any special features required and then negotiates with the supplier the term of warranties, maintenance arrangements, delivery, installation and most importantly, the purchase price of the equipment.

Hire purchase is a mode of financing the price of the goods to be sold on a future date and where 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. A hire-purchase agreement is a peculiar kind of transaction in which the goods are let on hire with an option to the hirer to purchase them, under the following conditions:

1. Payment to be made in installments over a specified period of time.
2. The possession is passed on to the hirer at the time of entering into the contract;
3. The title to goods passes on to the hirer on payment of the last instalment;
4. Each instalment is treated as hire charges so that if default any made in payment of instalments, the seller is entitled to take away the goods; and
5. The hirer/purchaser is free to return the goods without being required to pay any further instalments falling due after the return.

Thus, a hire-purchase agreement has two aspects.

Firstly, an aspect of bailment of goods subjected to the hire-purchase agreement, and Secondly, an element of sale becomes effective when the option to purchase is exercised by the intending purchaser. Though the option to purchase is

allowed in the very beginning, it can be exercised only at the end of the agreement.

The modus operandi of a hire-purchase transaction is structured around the following features:

The finance (hire-purchase) company purchases the equipment from the equipment supplier and lets it on hire to the hirer, who in turn is required to make a down payment of 20-25 per cent of the cost and pay the balance with interest in Equated Monthly Instalments (EMI) in advance or arrears spread over 36-48 months. Alternatively, in place of the margin in the down-payment plan, under deposit-linked plan, the hirer has to put an equal amount as a fixed deposit with the finance company which provides the entire finance on hire-purchase terms repayable with interest as EMI over 36-48 months. The deposit together with the accumulated interest is returned to the hirer after the payment of the last instalment.

#### **5.4.2. Hire-Purchase Vs Instalment Payment System**

In an instalment sale, the contract of sale is entered into, the goods are delivered and the ownership is transferred to the buyer but the price of the goods is paid in specified instalments over a definite period.

The first distinction between the two is based on the call option (to purchase the goods at any time during the term of the agreement) and the right of the hirer to terminate the agreement at any time before the payment of the last instalment (right of termination) in the former while in the latter the buyer is committed to pay the full price. Secondly, in instalment sale the ownership of the goods passes on to the purchaser simultaneously with the payment of the initial/first instalment, whereas in hire-purchase the ownership is transferred to the hirer, only when he exercises the option to purchase/or on payment of the last instalment.

### **5.4.3. Parties to Hire Purchase Contract:**

Normally, there will be two parties in a hire-purchase contract, viz., the intending seller and the intending purchaser or the hirer. But today, these contracts generally involve three parties, namely, the seller, the financier and the hirer. With the emergence of the fiancé function as a separate business activity and the substantial growth of finance companies in recent times, the sale element in a hire-purchase contract has been divorced from the finance element and as such a dealer normally arranges finance through a finance company.

A tripartite hire-purchase contract is arranged with the following modalities:

1. The dealer contracts with a finance company to finance hire-purchase deals submitted by him.
2. The customer selects the goods and expresses his desire to acquire them on hire-purchase, the dealer arranges for him the full set of documents generally supplied by the finance company to be completed to make it an agreement
3. The customer then makes cash down payment which is retained by the dealer as a payment on account of the price to be paid to him by the finance company.
4. The dealer then sends the documents to the finance company requesting them to purchase the goods and accept the hire-purchase.
5. The finance company, if it decides to accept the transaction, signs the agreement and sends a copy to the hirer along with the instructions as to the payment of the instalments and also notifies the same to the dealer and asks him to deliver the goods, if he has not already done so.
6. The dealer delivers the goods to the hirer against acknowledgments and the property in the goods passes on to the finance company.
7. The hirer makes payment of the hire instalment periodically.

8. On completion of the hire term and when the hirer pays the last instalment, the property in the goods passes on to the hirer on issue of a completion certificate by the finance company.

#### **5.4.4. Sales Vs Hire Purchase:**

A hire-purchase contract differs from sale in the sense that:

1. In a hire-purchase, the possession of the goods only is with the hirer and the ownership vests with the original owner. But in the case of sale, both possession and ownership passes on immediately.
2. In hire purchase there is no agreement to buy but only an option is given to the hirer to buy the goods under certain conditions. The ownership in the goods passes to the hirer when he exercises his option by making the full payment. But in the case of sale, there must be an agreement to buy.

#### **5.4.6. Taxation**

The taxation aspects of hire-purchase transactions are divided into three parts (i) income tax, (ii) sales tax and (iii) interest tax.

##### **5.4.6.1. Income tax**

Hire-purchase, as a financing alternative, offers tax benefits both to the hire-vendor, (hire-purchase finance company) and to the hire-purchaser (user of the asset).

##### **Assessment of Hire-Purchaser (Hirer):**

Circular issued by the Central Board of Direct Taxes in 1943 and subsequent court rulings, the hirer is entitled to claim depreciation as a deduction on the entire purchase price. One can also claim deduction on account of 'consideration for hire' i.e., finance charge which is the difference between the hire-purchase price and the cash price.

The hirer can choose any one of the alternatives, namely, (1) level/equal distribution, or (2) distribution on the basis of sum of year's digits method, or (3) rate of return method.



**Assessment of Owner (Hire- Vendor):**

The consideration for hire/hire charge is considered as income received by the hire-vendor which is liable to tax. The hire income from house property is also generally taxed as income from house property with normal deductions (except depreciation) allowed.

**5.4.6.2. Sales Tax:**

The rates of sales tax on hire-purchase deals vary from state to state and as such there is no uniformity even regarding the goods to be taxed.

**5.4.6.3. Interest Tax:**

The hire-purchase finance companies, like other credit/ finance companies have to pay interest tax under the Interest Tax Act, 1974. Interest tax is payable on the total amount of interest earned less bad debts in the previous year @ 2 per cent.

**5.4.7. Cost of Hire-Purchase:**

The Cost of Hire-Purchase to the hirer (CHP) consists of the following:

1. Down payment
2. Plus service charges
3. Plus present value of hire-purchase payments discounted by cost of capital ( $K_d$ )
4. Minus present value of depreciation tax shield discounted by cost of capital ( $K_p$ )
5. Minus present value of net salvage value discounted by cost of capital ( $K_c$ )

**5.4.8. Benefits of Hire-Purchase:**

1. Interest charged and depreciation of the assets are tax deductible
2. No capital outlay is required and uninterrupted cash flow is assured.
3. Terms can be flexible. And fixed installments of repayments make it easy the preparation of budgets.

4. After the last instalment payment of the hire purchase agreement, ownership of the goods got transferred.
5. The purchaser has the option to make payments with or without a balloon payment at the end of the term.

#### **5.4.9. GLOSSARY**

**Nature of Agreement:** States the nature, term and commencement of the agreement.

**Delivery of Equipment:** The place and time of delivery and the hirer's liability to bear deliver charges.

**Location:** That place where the equipment shall be kept during the period of hire.

**Inspection:** That the hirer has examined the equipment and is satisfied with it.

**Hire Charges:** To be paid by the hirer, the time schedule, the rate of interest/penalty for delayed payment/default.

**Repairs:** The hirer to obtain at his cost, insurance on the equipment and to hand over the insurance policies to the owner.

**Alteration:** The hirer, not to make any alterations, additions, etc., to the equipment, without the prior consent of the owner.

**Termination:** The events or acts of the hirer that would constitute a default eligible to terminate the agreement.

**Risk:** Of loss and damage to be borne by the hirer.

#### **5.4.10. Activities:**

1. Visit a Hire Vendor shop and obtain the procedure for selling under Hire Purchase System?

- |      |         |          |
|------|---------|----------|
| Step | 1. .... | 6. ....  |
|      | 2. .... | 7. ....  |
|      | 3. .... | 8. ....  |
|      | 4. .... | 9. ....  |
|      | 5. .... | 10. .... |

#### **5.4.11. Self Assessment Test**

1. Define Hire-Purchase? Explain its features?
2. Explain the Benefits of Hire Purchase?
3. Hire Purchase Vs Instalment system?
4. Hire Purchase Vs Sale.

### **5.5. CONSUMER FINANCING**

#### **5.5.1. Introduction and Meaning:**

Consumer financing refers to the providing of finance for unspecified uses or for the purchase of consumer durables by the employees of established corporate and other institutions. Here, the consumer pays back without or with an initial down payment covering a small portion of the consumer purchases, and the rest along with the agreed rate of interest over an agreed period of time.

The system of consumer financing made a modest beginning in the early eighties, made rapid progress covering almost all the consumers' oriented direct products and their marketing. The major implied consideration in the operation of consumer financing is the fact that most of the middle-income group consumers may find it difficult to save money for the purchase of consumer durables for marking payment at one lot. In order to lessen their burden of payment, and to switch over from keeping large sums of money as deposits, and to come out from their mind block of spending carefully and wisely the hard earned money, and the like many, consumer credit came into being. This consumer credit was the off shoot of small credits made by neighbors and known people to others which have grown far and wide. Today Banks, financial institutions, consumer durable products manufacturing companies, offer attractive and wide range of consumer credit to net all the consumers towards their products such as: cars, two wheelers, entertainment products, personal computers, house appliances, food processing appliances, etc.

### **5.5.2. Parties in Consumer Finance:**

The parties to consumer finance are many and primarily depend upon the nature of the contract. The contracts may be:

1. Bipartite agreement
2. Tripartite agreement
3. Multiparty agreement

(i) In a bipartite agreement, the two parties may be: (a) borrower/consumer and the financier, (b) borrower and financial institutions, and the like combinations.

(ii) In a tripartite agreement the parties are: consumer, dealer, and financier.

(iii) In a multiparty agreement, the parties may be: consumer, guarantor, financier, dealer, intermediary and others. The agreement composition parties may be varying according to the situation, namely, personal credit; educational credit; etc.

### **5.5.3. Types of Consumer Finance:**

A consumer finance agreement may take the form of any one of the following:

**(a).Hire Purchase:**It is an agreement where the consumer has agreed to purchase the product by paying the last instalment. It may take the form of: bipartite or tripartite or even multipartite one.

#### **(b). Personal Finance:**

It is an agreement to finance the personal needs of the consumer with/ without clearly defined objects. This can take the form of anyone of the three agreements, where the need and circumstances determine the parties.

#### **(c).Conditional Sale:**

The ownership is transferred to the customer only when the total purchase price including the credit charges are paid. However, the customer cannot terminate the agreement before the payment of the full price.

#### **(d).Credit Sale:**

The customer on payment of the first instalment itself becomes the owner of the products, but thereafter he cannot cancel the agreement.

#### **5.5.4. Terms of Payment:**

The consumer credit finance agreements fall into three categories. They are:

1. Instalment with initial payment schemes.
2. Instalment with no initial payment schemes.
3. Instalment with lead time schemes.
4. Deposit linked payment schemes.

The down payment may range between 20-25 per cent of the cost while the deposit may vary between 15-25 per cent of the amount financed at the compound rate of interest. Some agreements provide no deposit or zero down payment with higher Equated Monthly Instalment (EMI) have also been practiced. In certain special cases, initial lead time for repayment is also allowed.

The repayment period for the credit ranges between 12-60 monthly instalments. The effective rate of interest is normally expressed at a flat rate, but the effective rate of interest is generally not disclosed. However, the EMI associated with the different repayment periods will be mentioned. The security available for the credit provider varies from salary attachment to having a first charge on the asset, where the consumer cannot sell/pledge/hypothecate the asset.

#### **5.5.5. Shopping Is the First Step in credit schemes:**

Credit is a convenience. It lets one charge a meal on one's credit card, pay for an appliance on the installment plan, get a loan to buy a house, or pay for schooling and vacations. With credit, one can enjoy the purchase while one is paying for it, or one can make a purchase when one is lacking ready cash.

But there are strings attached to credit as well. It usually costs something. And, of course, what is borrowed must be paid back. If one is thinking of borrowing or opening a credit account, the first step should be to figure out how much it will cost one and whether one can afford it. Then only one should shop for the best terms.

### 5.5.6. Glossary:

**Annual Percentage Rate (APR)**—the cost of credit expressed as a yearly rate.

**Appraisal Fee**—the charge for estimating the value of property offered as security.

**Balloon Payment**—A large extra payment that may be charged at the end of a loan or lease.

**Billing Error**—any mistake in your monthly statement as defined by the Fair Credit Billing Act.

**Collateral**—Property, such as stocks, bonds or a car, offered to support a loan and subject to seizure if one defaults.

**Credit**—the right granted by a creditor to pay in the future to buy or borrow in the present; a sum of money due to a person or business.

**Credit History**—the record of how one borrowed and repaid debts.

**Creditor**—A person or business from whom one borrow or to whom one owe money.

**Credit Insurance**—Health, life, accident, or disruption of income insurance designed to pay the outstanding balance on a debt.

**Credit-Scoring System**—A statistical system used to rate credit applicants according to various characteristics relevant to creditworthiness.

**Creditworthiness**—Past, present, and future ability to repay debts.

purchases, withdrawals, or other types of electronic fund transfers.

**Default**—Failure to repay a loan or otherwise meet the terms of one’s credit agreement.

**Disclosures**—Information that must be given to consumers about their financial dealings.

**5.5.7. Activities:**

1. Visit a large consumer durable goods selling store and obtain the process of sanctioning consumer credit.

Step 1: 1	.....	5.....
2	.....	6.....
3	.....	7.....
3	.....	8.....

2. Meet any two of your friends who purchased car, Refrigerator, washing machine, T.V., etc., on credit basics and get their opinion about the purchase.

	Customer Name Address	Product Purchase of credit	Amount of Purchase	Credit item Opinions
1.	.....	.....	.....	.....
2.	.....	.....	.....	.....

3. Ask your friends about the various legislations and their provisions, if not in particular atleast in general, relating to consumer production.

## **Consumer Production Provisions**

- |         |        |
|---------|--------|
| 1. .... | 4..... |
| 2. .... | 5..... |
| 3. .... | 6..... |

### **5.5.8. Self Assessment Test:**

1. What do you mean by consumer finance?
2. Explain the features of consumer finance?
3. Bring out the protection measures available to the consumers?

## **5.6. INSURANCE**

### **5.6.1. Introduction**

The risks of the large group of persons are pooled and the actual loss suffered is compensated from the pooled funds, is the modes operandi of insurance.

In the contract of insurance, the insurer (insurance company) agrees/undertakes, in consideration of a sum of money (Premium), to make good the loss suffered by the insured against a specified risk such as fire and any other similar contingency or compensate the insured or benefactors on the happening of a specified event such as accident or death.

There are two types of insurance.

1. Life insurance – where the life of individuals got insured. The sum assured will be paid in cash when death of the insured occurred or on the expiry of the specified period of time, whichever occur earlier.
2. General insurance - this covers the losses by theft, fire accident, and the like.



### 5.6.2. Life insurance Vs General Insurance

	Criteria	Life insurance	General insurance
1.	Happening of an event	Certain	Uncertain
2.	Indemnity nature	Not Possible	Possible
3.	Insurable interest	At the time of the contract	Both at the time of the contract and at the time of loss
4.	Period	Continuing	Most cases annual.

### 5.6.3. Type of Insurance Policies:

#### 5.6.3.1. Life Insurance Policies

A contract of life insurance is a contract where, in consideration of the premium, the insurer agrees to pay a certain sum of money on the death of the assured or upon the expiry of a certain agreed period, whichever is earlier. The major life insurance policies are:

##### (a). Endowment Policy:

This policy holds that the insured amount is payable either at the end of a specified period or upon the death of the insured person, whichever is earlier. It may also be taken for: the marriage of children at or after a certain age, or the education of children after the death of the assured.

##### (b). Whole Life Policy:

It is the cheapest policy where the premium continues to be paid throughout the life of the assured, but the amount becomes payable only after his death.

##### (c). Limited Payment Life Policy:

It is similar to the whole life policy as to the case where the policy money is payable only after the death of the assured. However, the difference lies in respect of the payment of premium which is paid only for a certain period, or until the death of the assured, if it occurs within that period.

**(d).Joint Life Policy:**

The policy money becomes payable either on the maturity of the policy or on the death of any of the persons jointly insured. Partnership firms find this policy useful one which enables them to pay the capital of the deceased partner.

**(e).Convertible Whole Life Policy:**

The assured is given as option to convert the policy into an endowment policy after sometime, failing which the policy will continue as a whole life policy. The initial premium will be very low.

**(f).Annuities:**

The person pay premium in regular installments over a certain period or at one lot. After the assured reaches a certain age, the insurer pays back the money by monthly, quarterly, half-yearly installments which provide a source of regular income to the assured or to his dependents after the expiry of the specified period.

**(g).Sinking Fund Policy:**

A fixed amount is paid as premium annually which keeps on growing at a specified rate of interest. After the specified period, the company gets the entire money, which is used by the corporate for redemption of debentures, repayment of loans or for replacement of assets.

**(h).Double Accident Indemnity Policy:**

If the assured dies of an accident, survivors of the assured get double the amount of the policy.

**(i).Janata Policy:**

This type of policy can be taken out for a period of 10, 15 or 24 years, with the pre-condition that, the policy should mature before the assured reaches the age of 60 years. This policy can be taken by a person only before the age of 45 years. The formality of medical examination is not necessary if the person

taking out the policy is below the age of 35 years. No loan is granted against such policy.

#### **5.6.3.2. Fire insurance Policies**

This is a contract under which the insurer agrees, in consideration *of* the premium, to compensate the loss or damage caused by fire during a specified period. In case of loss, the assured can claim from the insurer the actual amount of loss, or the maximum amount specified in the contract, whichever is less. Some of the important fire insurance policies are:

##### **(a).Specific Policy:**

Under this policy, the loss suffered by the assured is covered only up to a specific amount which is less than the real value *of* the property, with the insertion of an average clause.

##### **(b).Comprehensive Policy:**

It is also known as an all-in-one policy because it covers losses arising from any kind of risks, such as, fire, theft, burglary, third party risks, and so on. It may also cover loss of profits for the period during which business transactions remained suspended due to fire.

##### **(c).Valued Policy:**

The insurer agrees to pay a fixed sum of money irrespective of the amount of loss to the insured. If the loss exceeds the fixed sum, the payment is quit justified, otherwise not. Being a contract of indemnity, no profit can be made out of any loss under an insurance policy, but this is what actually happens in this case.

##### **(d).Floating Policy:**

It covers property lying at different places against loss by fire, with an average clause.

##### **(e).Replacement or Reinstatement Policy:**

This policy seeks to check mischief by the possibility of receiving cash from the insurer, might himself become a party to the cost of replacement of the property

damaged or destroyed by fire. No cash payment, only the damaged or destroyed property is replaced or reinstated.

### **5.6.3.3. Marine Insurance Policies**

This branch of insurance relates to ships and their cargoes. The insurer indemnifies the insured against marine losses, that is, losses relating to marine adventure or to navigation or commerce on the sea. At times, such contract may extend to losses on inland waters or to any voyage. But this can be only by a clear provision in the contract to that effect. The main types of such policies are:

#### **(a).Voyage Policy:**

It insures the subject matter "at and from" or "from" one place to another. If the policy is "at and from a port", it covers the subject matter both while the ship is at the port of departure and also from the time of the sailing of the ship. "From a port" policy covers the subject-matter only when the ship sails from the port.

#### **(b).Time Policy:**

The subject matter is insured for a definite time not exceeding a year. If the policy period comes to an end while the ship is still away from its destination, it is taken care of by a "continuation clause", whereby the period is extended for such time as is necessary to take the ship safely to the port of destination.

#### **(c).Mixed Policy:**

It combines a "voyage" and a "time" policy. It covers the risk during a particular voyage for a specified period, e.g., "From Bombay to London' for six months".

#### **(d).Valued Policy:**

It is a policy which specifies the agreed value of the subject matter.

#### **(e).Open and Unvalued Policy:**

The value of the subject matter is not specified. In case of any loss, it is ascertained subject to the limit of the sum insured.

**(f).Floating Policy:**

This policy only mentions the amount for which the policy is being taken out. The particulars as to the ship or ships, on which the goods are, to be shipped, or as to the goods which are to be shipped, are left to be specified later.

**5.6.4. Insurance in the Present era:**

In view of the *(i)* need for competition which may offer choice to the public in terms of service, products and prices, *(ii)* vast untapped potential of many new line of business, private insurance companies should be allowed. However, mushrooming of small companies has to be avoided. No single company should be allowed to transact both life and general Insurance business. The number of new entrants should be controlled. The minimum paid-up capital for new entrants should be Rs 100 crores. However, a lower capital requirement can be preferred for state level cooperative institutions taking up life insurance business. The promoters' holding in a private insurance company should not exceed 40per cent of the total. However, if the promoters wish to start with a higher holding they should be permitted to do so provided their holding is brought down to 40percent within a specified period of time through public offering. No person other than the promoter should be allowed to hold more than 1 per cent of the equity. Promote should at no time hold less than 26 per cent of the paid-up capital.

If and when entry of foreign insurance companies is permitted, it should be done on selective basis. They should be enquired to float an Indian company for the purpose, preferably in joint venture with an Indian partner.

Before the private sector is allowed to enter the insurance field, the Control of Insurance should start functioning effectively. Regulatory and prudential norms as well as conditions for ensuring level playing fields among insurers should be finalized early so that aspiring entrants into the insurance- business would be aware of the stipulations they would have to comply with.

These conditions should aim to ensure that life insurers do not neglect the small man or the rural business and that the general insurers have balanced portfolios. Though nationalized insurance companies are in a position to face competition, it is essential that they quickly upgrade their technology, and reorganize themselves on more efficient lines.

#### **5.6.5. Regulation**

Insurance organisations are repositories of public trust. They sell promise to indemnify the insured upon the happening of specified events. They are to be regulated in some form or the other to ensure that business is run fairly, is conducted by competent persons, does not result in losses to the insurers leading to their insolvency and at the same time protects the legitimate interests of the insured.

Before the nationalisation of life and general Insurance, and the setting up of LIC in 1956 and GIC in 1973 as monolithic institutions, insurers were regulated under the provisions of the Insurance Act, 1938 which was administered by the Controller of Insurance (COI). The application of the Act was greatly modified by the nationalisation enactments and Government directions/notifications and most of the regulatory functions were taken away from the COI and vested in LIC GIC.

Having regard to both the present and the future scenarios, the Insurance Regulatory Authority (IRA) should be set up as a multi-member statutory body, similar to the Securities and Exchange Board of India (SEBI). It should have a full-time chairperson, two full-time and some part-time members. The chairperson and the members should be persons of ability, integrity and standing having knowledge of, and experience in, insurance, finance, administration, law other relevant disciplines. One member should have a strong general insurance background and another having experience in life insurance. The IRA should have full functional autonomy and operational flexibility to discharge its functions in a free and fair manner.

The principal functions of IRA would be as follows.

1. Subject to the provisions of law, to set capital adequacy, solvency margins and other prudential norms for entities that transact insurance business;
2. To examine, in the light of the prescribed criteria, applications for grant of registration for transacting insurance business, and to grant such registration where appropriate;
3. In the interest of consumer protection, to set standards for insurance products. " There should be a system of "File and Use" for insurance products subject to the power of IRA to modify the rates, terms and conditions within a prescribed time limit;
4. To ensure compliance with prescribed ceilings for management expenses of insurers and agency commissions;
5. To monitor the performance and quality of re-insurance;
6. To ensure maintenance of adequate technical reserves by the insurers;
7. To review insurers' asset distribution and management and particularly to monitor compliance with prescribed prudential norms and patterns of investment;
8. .To ensure high standards of accounting and transparency of balance sheets of insurance companies and to scrutinise and accept annual accounts, valuation reports and solvency margin statements;
9. To detect badly managed, unhealthy, or failing insurers and to take suitable corrective action, including appointment of administrators or to temporarily manage such companies and, when warranted, cancellation of registration;

10. Where necessary, to act as a "dispute resolution forum" for consumer grievances;
11. To prepare and publicise an annual report on the state of the insurance industry.
12. To maximise aggregate domestic retention and to minimise drain of exchange;
13. To encourage and to ensure availability of need-based and low cost insure products to the rural population and the urban poor;
14. To ensure a variety of insurance products in a free and fair market.

In due course, IRA may find it necessary to shoulder more responsibility to the changing character of the market. In the interest of autonomy, it should have an independent source for financing its establishment and activities for which purpose a levy of, say, 0.5 per cent of the premium income of insurance companies may be collected.

#### **5.6.6. Insurance Regulatory Authority (IRA)**

On September 6, 1995, the Government of India approved the setting up to interim IRA under the overall control of the Ministry of Finance to regulate the insurance sector in place of the Controller of Insurance. It has been entrusted with the task of preparing a comprehensive legislation to establish a statutory, autonomous IRA on the pattern of the SEBI.

#### **Salient Features:**

The salient features of the interim IRA are described as follows.

The Chairman of the IRA is the ex-officio Controller of Insurance (COI) and exercises all powers vested with the COI at present. The interim body is empowered to examine the powers withdrawn from the Col or modified through Government notifications issued from time to time, or delegated to the LIC and



GIC under nationalising enactments of the insurance business, need to be restored.

Subject to the over all directions and regulations, the IRA would deal with all matters relating to promotion and orderly growth of the insurance market propose a comprehensive legislation for the purpose indicated above and carry out such other non-statutory functions as may be delegated to the IRA/Chairman by the Central Government for these purposes. The IRA is free to determine its own procedures and has powers to call for records, returns, notes, memoranda, data or any other material relevant to its working from official and non-official bodies and also hold discussions with them. It is required to submit periodical reports to the Government on various aspects of the insurance companies and on such specific matters as may be called for by the Government form time to time.

#### **5.6.7. Activities**

1. Meet an insurance agent of your locality and obtain the features of the popular LIC and other polities.

	Name of the Policy	Features
1.	.....	.....
2.	.....	.....
3.	.....	.....
4.	.....	.....

2. Meet three or four friends who have taken different insurance policies and enquire about their merits and demerits.

	Name of the Policy	Merits	Demerits
1.	.....	.....	.....
2.	.....	.....	.....
3.	.....	.....	.....
4.	.....	.....	.....

3. Visit three or four business concerns and enquire about the features of different policies they have taken .

	Name of policies	Features
1.	.....	.....
2.	.....	.....
3.	.....	.....
4.	.....	.....

### **5.6.8. Self Assessment Test**

1. Explain the different types of insurance?
2. Name any five insurance policies?
3. Explain the role and importance of insurance in the present day scenario?
4. Public insurance Vs Private insurance.

## **5.7. FACTORING**

### **5.7.1. Introduction:**

Factoring is one of the most flexible financing options which not only provides the needed resources for financing receivables but also facilitates the speedy and efficient collection of debts of the company, or other obligations. As business grows, it is natural that the company is totally limited to pre-approved credit lines, and have to go through a complicated and redundant application process. But factoring allows one to focus on expanding the business by providing with the necessary capital and removing much of the administrative red tape. Factoring as a fund-based financial services existed long back in the financial scenario of the developed countries. But its existence in the developing and under developed countries cannot be ruled out completely, as they were the part of the financial system of these countries also in a most crude and unauthenticated form.

Factoring has the ironic distinction of being the financial backbone of many of America's most successful businesses, because it is not taught in business colleges, seldom mentioned in business plans and is relatively unknown to the majority business people. Yet, it is a financial process that frees up billions of dollars every year, enabling thousands of businesses to grow and prosper.

Business practices today dictate that in order to get business, the provider of goods and services, must extend terms to their customers.

These terms can squeeze the life, since cash is the lifeblood of any business, out of a new or struggling company. Factoring is the process of purchasing commercial accounts receivable (invoices) from a business at a discount.

Factoring has a long and rich tradition, dating back 4,000 years to the days of Hammurabi. Hammurabi was the king of Mesopotamia, which gets credit as the "cradle of civilization."

After a while, Hammurabi and the Mesopotamians went the way of extinct civilizations, but factoring endured. Almost every civilization that valued commerce has practiced some form of factoring, including the Romans who were the first to sell actual promissory note at a discount.

The first widespread, documented use of factoring occurred in the American colonies before the revolution. During this colonial times, factors made advances against the accounts receivable of clients, enabling the clients to continue with their operations, long before they had been paid for what they were sold.

With the advent of the Industrial Revolution, factoring became more focused on the issue of credit, although the basic premise remained the same. By assisting clients in determining the creditworthiness of their customers and setting credit limits, factors could actually guarantee payment for approved customers.

Prior to the 1930's, factoring in this country occurred primarily in the textile and garment industries, as the industries were direct descendants of the colonial economy that used factoring so specifically. After the war years, factors saw the potential to bring factoring to other forms of invoice-based business and the expansion began.

Today, factors exist in all shapes and sizes: as divisions of large financial institutions or, in larger numbers, as individually owned and operated entrepreneurial endeavors.

With banks becoming too expensive and too inflexible due to heavy regulation (remember the Savings and Loan crisis?), the small businessperson was forced

to find other sources of financing for expansion and growth. As more and more banks stop befriending the small business person, factoring is becoming an increasingly popular option. This year alone thousands of businesses will be selling crores of rupees in accounts receivable, and they are doing it for profit, growth, and in some cases, their very survival.

### **5.7.2. Definition:**

Factoring is a risk bearing activity, of a company safely transfers the risk of collecting those receivables which are not backed by negotiable instruments. If there are negotiable instruments, then financing may not be a problem, as these instruments can be discounted.

Factoring is an ever growing multifunctional financial service, which can not be put within the four walls of a definition. However, the try for a unique definition continues. The following are some of them.

Peter M.Biscose, "Factoring is a continuing legal relationship between a financial institution (the factor) and of business concern (the client) selling goods or providing services to trade customers whereby the factor purchases the clients' book debts either with or without recourse to the client and in relation thereto controls the credit extended to ledger".

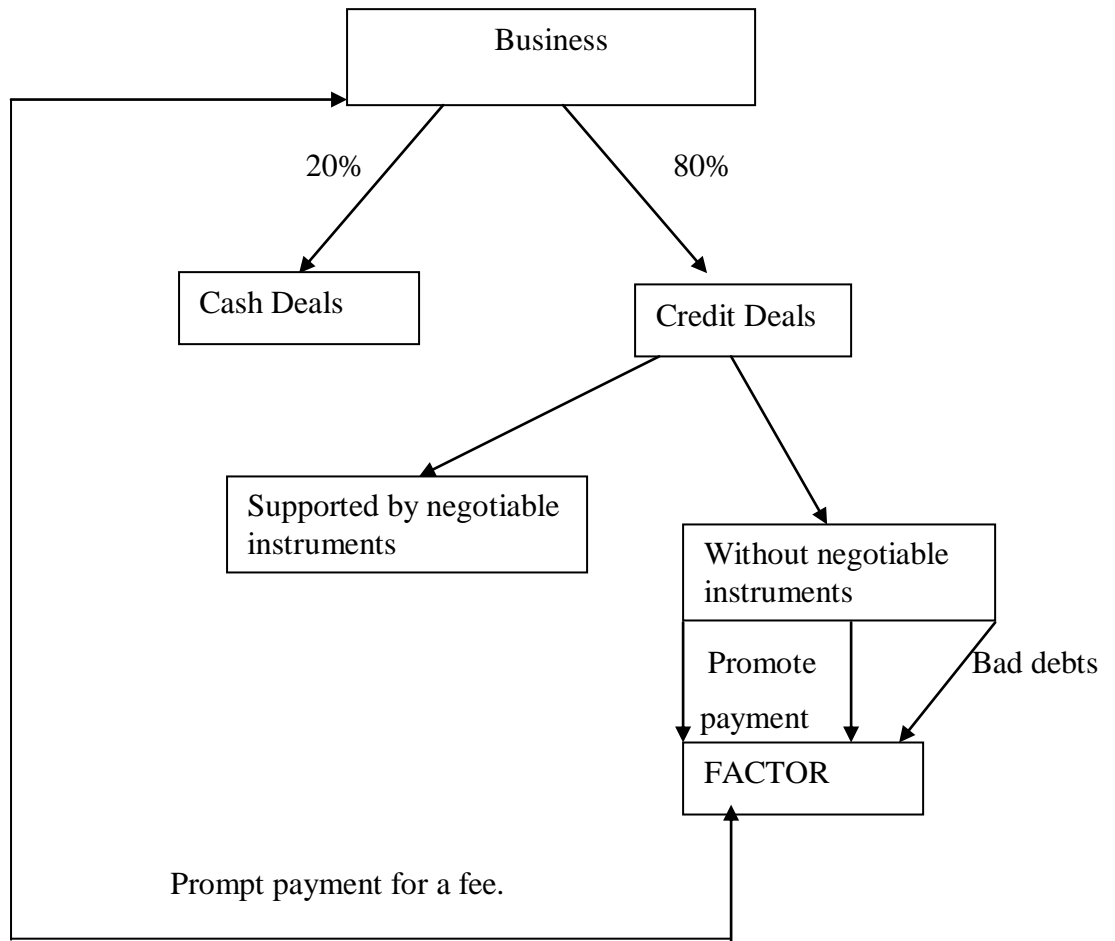
C.S. Kalyansundaram, "Factoring is the outright purchase of credit approved accounts receivables by the factor assuming bad debt losses"

The study group appointed by the International Instituted for the Unification of Private Law (UNIDROIT) recommended, in 1988, "factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor, namely, providing finance, maintenance of accounts, collection of debts, and giving protection against credit risk".

Thus, it can be very well stated that the factor is the financial intermediary who enters into the business scenario through the weakest link .

### 5.7.3. Entry of Factor

The entry of factors in the business system can be depicted through the following chart.



### 5.7.4. Working of Factoring

Factoring starts functioning in the business concern with the following steps.

1. A preliminary evaluation of the business and customer base is made.
2. Quick decisions are made, eliminating long waits for loan committee approval, which leads to a stage where, if one fills an order or complete a

contract for services and generate an invoice, the Factor will fund that invoice and advance a large percentage of the face amount immediately.

3. The factor's fees are determined by the amount financed, average invoice size and collection time. All fees are clearly stated in the agreement with no hidden charges.

4. The factor provides comprehensive, password protected on-line management reports to all the clients. These reports allow one to make informed decisions based on real time information.

5. How much and how often to factor is entirely up to the client. They can choose to factor all or a portion of their receivables for a length of time that works best for them.

6. If one has outgrown one's line of credit with one's bank, or if it is a young company without an established track record, or if previous cash flow problems have tarnished one's credit rating, or even if one has a tax line, still one can quality.

#### **5.7.5. Services of Factors:**

Factoring is an agreement based service provided by the 'Factor' to a 'Seller' (a client). The client is at the most advantages position where he can limit factoring and also discontinue it after the lapse of the agreement. However, it is advisable for the continuance of the agreement of factoring considering the benefits that accrue to the business concern.

The following are the generally accepted factoring services. They are:

1. Purchase of all the accounts receivables of the sellers for cash.
2. Administration / Maintenance of the agreed sales ledgers of the client;
3. Collecting the agreed accounts receivables;
4. Assuming the credit risks, credit control and credit protection ; and
5. Advising the seller at the needed and appropriate time.

### **5.7.6. Benefits of factoring:**

This financial service benefits the company in many ways. Some of them are:

- Avoid the loss of business to competitors who are better financed.
- The clients can spend less time in managing their receivables and spend more time in managing their other business activities.
- Cash can be got on the invoices within 24 hours.
- Stabilises the cash flow.
- Take advantage of purchase discounts.
- Stop worrying about meeting payroll at the last minute.
- Improve the company's credit status.
- Pay off loans and other debts.
- Meet seasonal demands.
- Offer better credit terms to one's customers.
- One's "Line of Credit" grows as their business grows.
- Purchase inventory sooner and fill orders faster.
- Fund marketing efforts to grow the business.
- Reinvest in the business.
- Quick, simple and straightforward.
- Prompt funding
- Credit based on the customers' strengths.
- Accurate and comprehensive online financial reports, issued in real time so one can always know where you stand.
- Detailed account statements.
- Account Receivable records management.
- Fast, personalized attention.

### 5.7.7. Comparison of Factoring to Other traditional financial services:

Features	Factoring	Leasing	Going Public	Venture Capital	Bank Loan
Simple Application	Yes	No	No	No	Varies
Required Personal Guarantees	No	Possibly	No	Yes	Possibly
Days to Fund	3to10	15to30	120to270	60 to 180	60 to 180
Approval based on Prospect's credit	No	Yes	Yes	Yes	Yes
Funding tied to sales	Yes	No	No	No	No
Give up equity	No	No	Yes	No	No
Give up control	No	No	Possibly	No	Possibly
Limited to asset value	No	Yes	No	Yes	Possibly
Requires Profitability	No	Usually	Yes	Yes	Usually
On-going monitoring	No	No	Yes	Yes	Yes
Reduce Overhead	Yes	No	No	No	No

### 5.7.8 Types of Factoring:

The important forms of factoring are:

#### (a).Recourse and Non-recourse Factoring:

The factor has recourse to the client (firm) if the debt purchased/receivable factored turns out to be irrecoverable, under recourse factoring. The factor does not bear the credit risks and if the customer defaults in repayment, the client must make good the loss incurred by the factor. The factor's charges include: maintenance charges of the sales ledger, debt collection expenses, and the interest on the amount advanced by the factor.

In the case of non-recourse factoring, the loss arising out of bad debts are to be borne by the factor himself but for that he charges a higher commission, known as a del credere commission. Here the factor is also actively associated with the process of grant of credit and the extension of line of credit to the customers of the client



**(b).Advance and Maturity Factoring:**

A pre-specified portion, ranging between three-fourths to nine-tenths, of the factored receivables will be paid as advance by the Advance Factor and the balance will be paid upon collection/on the guaranteed payment date.

A bank gives an advance to the client to finance a part, say 50 per cent, of the factor reserve, which is called Bank Participation Factoring- an extension of advance factoring.

Under Maturing Factoring/ Collection Factoring, the factor makes the pre-payment to the client either on the guaranteed payment date or on the date of collection

**(c).Full Factoring or Old Line Factoring:**

Under Full factoring, all the services, namely, collection, credit protection, sales-ledger administration and short-term finance, of the factors will be provided.

**(d).Disclosed and Undisclosed Factoring:**

The name of the factor is disclosed in the invoice by the supplier/manufacturer of the goods directing the debtor to make payment to the factor, normally on a recourse basis, under the disclosed factoring.

The name of the factor is not disclosed in the invoice but the factor maintains the sales ledger of the supplier or manufacturer, who also provide short term funds, under Undisclosed Factoring.

**(e).Domestic and Export/Cross-Border/International Factoring:**

1. Three parties, namely, customer (buyer), client (seller-supplier) and factor (financial intermediary) who domicile in the same country are involved in the domestic factoring. Normally four parties, (i) exporter (client), (ii) importer (customer), (iii) export factor and (iv) import factor are involved in the Export Factoring.

### 5.7.9. Factoring Vs Bills Discounting:

**Similarities:** These services provide short-term finance and in both cases the clients would have otherwise received payment from the buyer at the end of the credit period.

**Differences:**

CRITERIA	Bill Discounting	Factoring
1.Risk taking	Always with recourse	Either with recourse or without recourse.
2.Collection responsibility	The drawer to collect and remit to the funding agency	Factor collects on behalf of the client
3.Services	Provision of finance only	Other services also undertaken
4.Rediscounting	Can be done several times, before maturity	Cannot be done
5.Nature	Individual transaction oriented	Several unpaid trade related invoices oriented
6.Mode	Balance mode of financing	Off- balance mode
7.Assignment	Does not involve assignment of debt	Based on assignment only

### 5.7.10. Factoring in India :

1. In India, as such Factoring service came very recently only. It owes its genesis to the recommendations of the Kalanasundaram Study Group appointed by the RBI in 1989. But the RBI issued guidelines for factoring services in 1990. the first factoring company- SBI Factors and Commercial Ltd. (SBI FACS) started operation in April 1991. .

### 5.7.11. Activities:

1. Visit the premises of a factor in your town or nearly town and enquire about the functions he performs .

Name & Address of the factory issued	Functions, as total by them.
1. ....	.....
2. ....	.....
3. ....	.....
4. ....	.....

2. Go to a business hours or a banker and chart down the process of bills discounting

Step	1.	.....	5.	.....
	2.	.....	6.	.....
	3.	.....	7.	.....
	4.	.....	8.	.....

3. Go and meet the owner of a large age old business house of your area, and enquire the methods of collection money from the kinds of debtors of the firm aver the years.

	Kind of Debits	Methods used of collection money.
(a).	Good debits	.....
(b).	Doubtful debits	.....
(c).	Bad debits including time barred debits	.....

**5.7.12. Self Assessment Test:**

1. Define a Factor? Explain his working?
2. Compare factoring with other Traditional methods of financing business?
3. Explain:
  - (a) Factors as a financier?
  - (b) Factor as a collector of debits?
4. Explain with example any five different types of factoring?
5. As a large providing business man in your area, do you favour factoring? Support your answer.

**5.9 CREDIT CARDS**

**5.9.1. Introduction**

According to Encyclopedia Britannica, the use of credit cards originated in the United States during the 1920s, when individual companies, such as hotel chains and oil companies, began issuing them to customers for purchases made at those businesses. This use increased significantly after World War II.

The first **universal credit card** -- one that could be used at a variety of stores and businesses -- was introduced by Diners Club, Inc., in 1950. With this system, the credit-card company charged cardholders an annual fee and billed them on a monthly or yearly basis. Another major universal card -- "Don't leave home without it!" -- was established in 1958 by the American Express company.

Later, the bank credit-card system came into existence. Under this, the bank credits the account of the merchant as sales slips are received (this means merchants are paid quickly -- something they love) and assembles charges to be billed to the cardholder at the end of the billing period. The cardholder, in turn, pays the bank either the entire balance or in monthly installments with interest (sometimes called carrying charges).

Diner's card was the first card in the Indian market launched in 1960. Cards are now estimated over 2.5. Million and the Citibank had emerged as the largest card issuing bank.

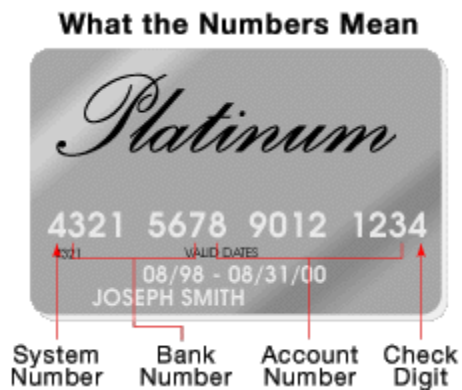
### **5.9.2. Definition**

A credit card is a thin plastic card, with a magnetic strip usually 3-1/8 inches by 2-1/8 inches in size that contains identification information such as a signature or picture, and authorizes the person named on it to charge purchases or services to his account -- charges for which he will be billed periodically. Today, the information on the card is read by: automated teller machines (ATMs), store readers, and bank and Internet computers.

### **5.9.3. Essential Features:**

1. The numbers in the credit card.

**ANSI Standard X4.13-1983** is the system used by most national credit-card systems.

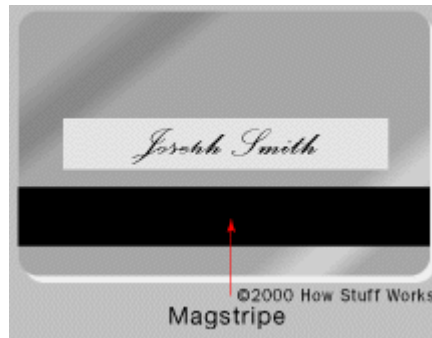


**Here are what some of the numbers stand for:**

- The first digit in the credit-card number signifies the **system**:
- **The structure** of the card number varies by system. For example, American Express card numbers start with 37; Carte Blanche and Diners Club with 38.
- **American Express** - Digits three and four are type and currency, digits five through 11 are the account number, and digits 12 through 14 are the card number within the account and digit 15 is a check digit.
- **Visa** - Digits two through six are the bank number, digits seven through 12 or seven through 15 are the account number and digit 13 or 16 is a check digit.
- **MasterCard** - Digits two and three, two through four, two through five or two through six are the bank number (depending on whether digit two is a 1, 2, 3 or other). The digits after the bank number up through digit 15 are the account number, and digit 16 is a check digit.

**2. The stripe on the back**

The stripe on the back of a credit card is a **magnetic stripe**, often called a **magstripe**. The magstripe is made up of tiny iron-based magnetic particles in a plastic-like film. Each particle is really a tiny **bar magnet** about 20-millionths of an inch long.



The magstripe can be "**written**" because the tiny bar magnets can be **magnetized** in either a north or south pole direction.

### 3. Authentication

There are three basic methods for determining whether your credit card will pay for what you're charging:

- Merchants with few transactions each month do **voice authentication** using a touch-tone phone.
- **Electronic data capture** (EDC) magstripe-card swipe terminals are becoming more common -- so is swiping your own card at the checkout.
- **Virtual terminals** on the Internet.

Likewise, the communications between the ATM and the bank's central computer are encrypted to prevent would-be thieves from tapping into the phone lines, recording the signals sent to the ATM to authorize the dispensing of cash and then feeding the same signals to the ATM to trick it into unauthorized dispensing of cash.

If this isn't enough protection to ease your mind, there are now cards that utilize even more security measures than your conventional credit card: Smart Cards

#### 5.9.4. Card Types:

Types of Credit Card Based on consumer demands.



**Low Interest Credit Cards**

Credit Cards with 0% intro APR's & low fixed rate offers



**Instant Approval Cards**

Get approved instantly on select credit cards from specific banks



**Balance Transfer Cards**

Transfer a high interest balance onto a low APR credit card



**Prepaid Debit Cards**

Control your spending with a prepaid debit card



**Rewards Credit Cards**

Credit Cards that "Reward" you for your purchases



**Credit Cards for Bad Credit**

Cards for people who are looking to re-establish their credit



**Cash Back Credit Cards**

Credit Cards that allow you to earn cash back on purchases



**Student Credit Cards**

Credit Cards for High School & College Students



**Airline Credit Cards**

Earn frequent flyer miles with an airline credit card



**Business Credit Cards**

Cards for corporate & small business owners

**Card Types**

There are basically three types of credit cards:

- **Bank cards**, issued by banks (for example, SBI Cards, ICICI Cards, Visa, MasterCard etc.,
- **Travel and entertainment (T&E) cards**, such as American Express and Diners Club
- **House cards** that are good only in one chain of stores (Sears is the biggest one of these, followed by the oil companies, phone companies and local department stores.)

Another familiar one is known as an affinity card. This card -- typically a MasterCard or Visa -- carries the logo of an organization in addition to the lender's emblem. Usually, these cardholders derive some benefit from using the card -- maybe frequent-flyer miles or points toward merchandise.

### **5.9.5. Credit Card System:**

Any bank (credit organization) that issues credit cards would have entered into an agreement several establishments, hotels, airlines, retail establishments, travel agencies, jewelry shops, super markets, hospitals, nursing homes, petrol pumps, etc, in various parts of the country. These are called 'member establishments'. The agreement is to provide goods and services on credit to the credit card holders after satisfying themselves about the identity of the card-holder. While supplying the goods, the card-holder's signature is taken on the bill. This is prepared in 'triplicate'. This serves as an authenticated and accepted document evidencing the supply of goods to the card-holder. Once a fortnight, a member establishment is required to prepare a statement furnishing the details of the bills, bank-wise and send the same to the banks. The banks on its part, make payment to the member establishments without delay after deducting up on the agreed discount. The bank, in turn, prepares consolidated statements, customer-wise giving details of the several amounts due fro the purchase made from various member establishments and sends it to the concerned card-holders. Every card holder is then required to make payment within a stipulated period (normally a month). A card-holder has an option either to pay lump sum, within the given period, in that case it is an interest free credit availed, or in installments. However, a credit card-holder is expected to pay a prescribed minimum percentage of his balance and the organization changes interest every month on the balance amount.

1. Card-holder makes purchases from member establishments.
2. Fortnightly statement sent to the banks by member establishment.
3. Payment by the bank to the member establishments.
4. Card organization sends consolidated statement of purchases to the card-holders.
5. Card-holders makes payment in full or in part to the card organization.



### **5.9.6. Benefits**

#### **I. To the card-holder**

- a. it is convenient for him as it enables cash-less transactions. Thus the risk factor of carrying cash is avoided.
- b. He gets credit from the banks without going through the time consuming formalities.
- c. It inculcates a sense of financial discipline.
- d. It provides a proof of spending through banking channels.
- e. He has the convenience of making a single payment for the purchase made during the month.
- f. It can become very handy in case of emergencies.
- g. It also facilitates insurance cover/discount.
- h. A special status and importance in society etc.

#### **II. To the Member establishment**

- a. Increase in sales because of increased purchasing power of the card-holder due to unbilled credit available to the card-holder.
- b. Systematic accounting since sales receipts are routed through banking channels.
- c. Advertising and promotional support on a national scale.
- d. Development of a prestigious clientele base.
- e. Assured and immediate payment by the banks.
- f. Avoid the entire cost and security problem involved in handling cash.

#### **III. To Banks**

- a. Scope and potential for better profitability out of share earned from the traders turnover.
- b. Helps in establishing banking relationship with new customers.
- c. This also provides additional customer service to the existing clients.
- d. Higher popularity and image for the banks.

- e. Substantial income through membership fees and by way of interest on delayed payments.

#### **5.9.7 Shopping tips:**

Keep these tips in mind when looking for a credit or charge card.

1. Shop around for the plan that best fits your needs.
2. Make sure you understand a plan's terms before you accept the card.
3. Hold on to receipts to reconcile charges when your bill arrives.
4. Protect your cards and account numbers to prevent unauthorized use.
5. Draw a line through blank spaces on charge slips so the amount can't be changed. Tear up carbons.
6. Keep a record - in a safe place separate from your cards - of your account numbers, expiration dates and the phone numbers of each issuer to report a loss quickly.
7. Carry only the cards you think you'll use.

#### **5.9.8. Indian Scenario**

Indian card-holder basis still relatively small but has high potential market. Among the banks issuing card, the esteemed and well publicized banking institutions are Citibank Diners Club card, Citibank Visa card and Credit cards, Bank of Baroda's Master care, ANZ Grindlays Credit and Visa Cards, the SBI's credit card, Bank of India's India card, Taj premium card and ATM card. Canara bank's Cancard, ICICI bank card etc.,

In the days to come credit card will play a very important role in tourism development which is not only the biggest foreign exchange earner, but also pays a vital role in the improvement of net national income and employment generation. The future holds unlimited potential to this card business. "The

future is smart card technology to support credit cards, debt cards and the electronic purse”.

**5.9.9. Activities**

1. Collect the credit cards brochures issued by different bank in India and go through them to know better.

	Name of the card	issuing institutions	Features specified
a.	.....	.....	.....
b.	.....	.....	.....
c.	.....	.....	.....
d.	.....	.....	.....

2. Go to the business houses which accept credit cars and obtain the information as to the invoice charging procedure. Keep the following record.

Step 1 .....	Step 5.....
Step 2 .....	Step 6.....
Step 3 .....	Step 7 .....
Step 4.....	Step 8 .....

3. Try to create a credit card of your own for a service of wide acceptance.

Name of the credit Card:

Features .....	.....	.....
.....	.....	.....
.....	.....	.....

If possible Design it:

**5.9.10. Self Assessment Test:**

1. Write Short notes on:
  - a. Credit Card
  - b. Debit card.
2. Name any five cordite cards you know with examples.
3. What are benefits of credit cards?
4. Explain the future of credit cards in the Indian economy?
5. Explain the features of any five types of credit cards?

**5.9.11. Glossary**

A credit card is a form of borrowing that often involves charges. Credit terms and conditions affect your overall cost. So it's wise to compare terms and fees **before** you agree to open a credit or charge card account. The following are some important terms to consider that generally must be disclosed in credit card applications or in solicitations that require no application.

### **Annual Percentage Rate**

The APR is a measure of the cost of credit, expressed as a yearly rate. It also must be disclosed before you become obligated on the account and on your account statements.

**Free Period.** Also called a "grace period," a free period lets you avoid finance charges by paying your balance in full before the due date. Knowing whether a card gives you a free period is especially important if you plan to pay your account in full each month. Without a free period, the card issuer may impose a finance charge from the date you use your card or from the date each transaction is posted to your account. If your card includes a free period, the issuer must mail your bill at least 14 days before the due date so you'll have enough time to pay.

**Annual Fees.** Most issuers charge annual membership or participation fees. They often range from Rs.100 to Rs. 1000 sometimes up to Rs. 750; "gold" or "platinum" cards often charge up to Rs.500 and sometimes up to several hundred rupees.

### **Transaction Fees and Other Charges**

A card may include other costs. Some issuers charge a fee if you use the card to get a cash advance, make a late payment, or exceed your credit limit. Some charge a monthly fee whether or not you use the card.

## **8 MUTUAL FUNDS**

### **5.8.1. Introduction**

Mutual Fund is a trust that pools the savings of a number of investors, which is invested by the fund manager in different types of securities, ranging from shares, debentures, and money market instruments. The income thus earned through these investments and the appreciated capital realized will be shared by its unit holders in the proportion of their holdings. Thus, it is the most suitable investment for the small investors, offering an opportunity to invest in diversified and professionally managed portfolio at a relatively low cost. Any person with as little as a few thousand rupees can invest in Mutual Funds, which has a defined investment objective and strategy.

Today, there are more than 500 Mutual Funds Schemes with more than Rs 250,000 crores in assets. At times, investors wrongly equate mutual funds with “shares” or equity. Mutual Funds have varying degrees of risks, with varying degrees of returns which varies according to the type of fund one invests in. Since the type of schemes available is different and varying, one scheme atleast will suit the requirements of any type of investor at any stage of life, today.

A draft offer document is to be prepared at the time of launching the fund. It pre specifies the investment objectives of the fund, the risk associated, the costs involved in the process and the broad rules for entry into and exit from the fund and other areas of operation. In India, as in most countries, these sponsors need approval from a regulator called SEBI (Securities exchange Board of India).

### **5.8.2. Types of Mutual Funds**

#### **I.By Structure:**

#### **( a )Open-ended Funds**

This is available for subscription throughout the year with no fixed maturity. Investors can conveniently buy and sell units at Net Asset Value ("NAV") related prices. The main feature is its liquidity.

### **( b )Closed-ended Funds**

This has a stipulated maturity period, generally ranging from 3 to 15 year and is open for subscription only during a specified period, where the Investors can invest at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the listed stock exchanges. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes must be provided to the investor.

### **( c )Interval Funds**

They combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.

## **ii. By Investment Objective:**

### **( a ) Growth Funds**

The aim of growth funds is to provide capital appreciation over the medium to long- term by investing a majority of their corpus in equities. It has been proven that returns from stocks, have outperformed most other kind of investments held over the long term. These schemes are ideal for investors having a long-term outlook seeking growth over a period of time.

### **(b) Income Funds**

The aim of such funds are to provide regular and steady income to investors by investing in fixed income securities such as bonds, corporate debentures and Government securities.

### **( c ) Balanced Funds**

The aim is to provide both growth and regular income by periodically distributing a part of their earning and investing both in equities and fixed income securities in the proportion indicated in their offer documents. This is ideal for investors looking for a combination of income and moderate growth.

### **iii. Money Market Funds**

The aim is to provide easy liquidity, preservation of capital and moderate income by investing in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. These are ideal for Corporate and individual investors as a means to park their surplus funds for short periods where the returns will fluctuate depending upon the interest rates prevailing in the market.

#### **( a) Load Funds**

Here, one charges a commission for entry or exit ie, when each time one buys or sells units in the fund, a commission will be payable. It could be worth paying the load, if the fund has a good performance history , where the loads ranges from 1% to 2%.

#### **(b) No-Load Funds**

No commission is payable on purchase or sale of units in the fund. The advantage of this fund is that the entire corpus is put to work.

#### **Other Schemes:**

##### **Tax Saving Schemes**

Tax saving schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961.

##### **Special Schemes**

##### **Industry Specific Schemes**

Industry Specific Schemes invest only in the industries specified and is limited to specific industries like InfoTech, FMCG, Pharmaceuticals etc.

- **Index Schemes**

These Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50

- **Sectoral Schemes**

Under these schemes funds are invested exclusively in a specified industry or a group of industries or various segments such as 'A' Group shares or initial public offerings.

### **5.8.3 Benefits of Mutual Fund investment**

#### **1. Professional Management**

They provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

#### **2. Diversification**

They invest in a number of companies across a broad cross-section of industries and sectors, where diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. One achieves this diversification through a Mutual Fund with far less money than one can do on their own.

#### **3. Convenient Administration**

It reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies and at the same time saves one's time and make investing easy and convenient.

#### **4. Return Potential**

They have the potential to provide a higher return as they invest in a diversified basket of selected securities over a medium to long-term.

#### **5. Low Costs**

They are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.



## **6.Liquidity**

**In** open-end schemes, the investor gets the money back promptly at net asset value related prices from the Mutual Fund. In closed-end schemes, the units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.

## **7. Transparency**

Regular information on the value of the investments in addition to disclosure on the specific investments made by the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook are published periodically.

## **8.Flexibility**

One can systematically invest or withdraw funds according to one's needs and convenience through regular investment plans, regular withdrawal plans and dividend reinvestment plans.

## **9. Affordability**

A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy where the small Investors individually may lack sufficient funds to invest in high-grade stocks.

## **10.Choice of Schemes**

Mutual Funds offer a family of schemes to suit one's varying needs over a lifetime.

## **11. Well Regulated**

All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors, the operations of which are regularly monitored by SEBI.

### **5.8.4. Mutual Funds in India (1964-2005)**

41 years of existence of mutual funds in this country ride through these rough weather and the investor opinion is still divided.

The impetus for establishing a formal institution came from the desire to increase the propensity of the middle and lower groups to save and to invest. UTI came into existence during a period marked by great political and economic uncertainty in India. With war on the borders and economic turmoil that depressed the financial market, entrepreneurs were hesitant to enter capital market.

The already existing companies found it difficult to raise fresh capital, as investors did not respond adequately to new issues. Earnest efforts were required to canalize savings of the community into productive uses in order to speed up the process of industrial growth.

The then Finance Minister, T.T. Krishnamachari set up the idea of a unit trust that would be "open to any person or institution to purchase the units offered by the trust. However, this institution as we see it, is intended to cater to the needs of individual investors, and even among them as far as possible, to those whose means are small."

His ideas took the form of the Unit Trust of India, an intermediary that would help fulfill the twin objectives of mobilizing retail savings and investing those savings in the capital market and passing on the benefits so accrued to the small investors.

UTI commenced its operations from July 1964. With a view to encouraging savings and investment and participation in the income, profits and gains accruing to the Corporation from the acquisition, holding, management and disposal of securities. Different provisions of the UTI Act laid down the structure of management, scope of business, powers and functions of the Trust as well as accounting, disclosures and regulatory requirements for the Trust.

One thing is certain – the fund industry is here to stay. The industry was one-entity show till 1986 when the UTI monopoly was broken when SBI and Canbank mutual fund entered the arena. This was followed by the entry of others like BOI, LIC, GIC, etc. sponsored by public sector banks. Starting with

an asset base of Rs0.25bn in 1964 the industry has grown at a compounded average growth rate of 26.34% to its current size of Rs1130bn.

The period 1986-1993 can be termed as the period of public sector mutual funds (PMFs). From one player in 1985 the number increased to 8 in 1993. The party did not last long. When the private sector made its debut in 1993-94, the stock market was booming.

The opening up of the asset management business to private sector in 1993 saw international players like Morgan Stanley, Jardine Fleming, JP Morgan, George Soros and Capital International along with the host of domestic players join the party. But for the equity funds, the period of 1994-96 was one of the worst in the history of Indian Mutual Funds.

#### **5.8.5. Market Trends**

A lone UTI with just one scheme in 1964, now competes with as many as 400 odd products and 34 players in the market. In spite of the stiff competition and losing market share, UTI still remains a formidable force to reckon with.

Last six years have been the most turbulent as well as exiting ones for the industry. New players have come in, while others have decided to close shop by either selling off or merging with others. Product innovation is now passé with the game shifting to performance delivery in fund management as well as service. Those directly associated with the fund management industry like distributors, registrars and transfer agents, and even the regulators have become more mature and responsible.

The industry is also having a profound impact on financial markets. While UTI has always been a dominant player on the bourses as well as the debt markets, the new generation of private funds which have gained substantial mass are now seen flexing their muscles. Fund managers, by their selection criteria for stocks have forced corporate governance on the industry. By rewarding honest and transparent management with higher valuations, a system of risk-reward has been created where the corporate sector is more transparent than before.

Funds have shifted their focus to the recession free sectors like pharmaceuticals, FMCG and technology sector. Funds performances are improving. Funds collection, which averaged at less than Rs100bn per annum over five-year period spanning 1993-98 doubled to Rs210bn in 1998-99. In the current year mobilization till now have exceeded Rs300bn. Total collection for the current financial year ending March 2000 is expected to reach Rs450bn.

What is particularly noteworthy is that bulk of the mobilization has been by the private sector mutual funds rather than public sector mutual funds. Indeed private MFs saw a net inflow of Rs. 7819.34 crore during the first nine months of the year as against a net inflow of Rs.604.40 crore in the case of public sector funds.

Mutual funds are now also competing with commercial banks in the race for retail investor's savings and corporate float money. The power shift towards mutual funds has become obvious. The coming few years will show that the traditional saving avenues are losing out in the current scenario. Many investors are realizing that investments in savings accounts are as good as locking up their deposits in a closet. The fund mobilization trend by mutual funds in the current year indicates that money is going to mutual funds in a big way. The collection in the first half of the financial year 1999-2000 matches the whole of 1998-99.

India is at the first stage of a revolution that has already peaked in the U.S. The U.S. boasts of an Asset base that is much higher than its bank deposits. In India, mutual fund assets are not even 10% of the bank deposits, but this trend is beginning to change. Recent figures indicate that in the first quarter of the current fiscal year mutual fund assets went up by 115% whereas bank deposits rose by only 17%. (Source: Thinktank, The Financial Express September, 99)

This is forcing a large number of banks to adopt the concept of narrow banking wherein the deposits are kept in Gilts and some other assets which improves liquidity and reduces risk. The basic fact lies that banks cannot be ignored and they will not close down completely. Their role as intermediaries cannot be

ignored. It is just that Mutual Funds are going to change the way banks do business in the future.

### **Banks v/s Mutual Funds**

Comparable criteria	<b>BANKS</b>	<b>MUTUAL FUNDS</b>
Returns	Low	Better
Administrative exp.	High	Low
Risk	Low	Moderate
Investment options	Less	More
Network	High penetration	Low but improving
Liquidity	At a cost	Better
Quality of assets	Not transparent	Transparent
Interest calculation	Minimum balance between 10th. & 30th. Of every month	Everyday
Guarantee	Maximum Rs.1 lakh on deposits	None

### **Global Scenario**

#### **Some basic facts**

- The money market mutual fund segment has a total corpus of \$ 1.48 trillion in the U.S. against a corpus of \$ 100 million in India.
- Out of the top 10 mutual funds worldwide, eight are bank- sponsored. Only Fidelity and Capital are non-bank mutual funds in this group.
- In the U.S. the total number of schemes is higher than that of the listed companies while in India we have just 277 schemes
- Internationally, mutual funds are allowed to go short. In India fund managers do not have such leeway.
- In the U.S. about 9.7 million households will manage their assets on-line by the year 2003, such a facility is not yet of avail in India.
- On- line trading is a great idea to reduce management expenses from the current 2 % of total assets to about 0.75 % of the total assets.
- 72% of the core customer base of mutual funds in the top 50-broking firms in the U.S. are expected to trade on-line by 2003.

Internationally, on- line investing continues its meteoric rise. Many have debated about the success of e- commerce and its breakthroughs, but it is true that this aspect of technology could and will change the way financial sectors function. However, mutual funds cannot be left far behind. They have realized the potential of the Internet and are equipping themselves to perform better.

Such increases in volumes are expected to bring about large changes in the way Mutual Funds conduct their business.

Here are some of the basic changes that have taken place since the advent of the Net.

- Lower Costs: Distribution of funds will fall in the online trading regime by 2003 . Mutual funds could bring down their administrative costs to 0.75% if trading is done on- line. As per SEBI regulations , bond funds can charge a maximum of 2.25% and equity funds can charge 2.5% as administrative fees. Therefore if the administrative costs are low , the benefits are passed down and hence Mutual Funds are able to attract mire investors and increase their asset base.
- Better advice: Mutual funds could provide better advice to their investors through the Net rather than through the traditional investment routes where there is an additional channel to deal with the Brokers. Direct dealing with the fund could help the investor with their financial planning.
- In India , brokers could get more Net savvy than investors and could help the investors with the knowledge through get from the Net.
- New investors would prefer online : Mutual funds can target investors who are young individuals and who are Net savvy, since servicing them would be easier on the Net.
- India has around 1.6 million net users who are prime target for these funds and this could just be the beginning. The Internet users are going to increase dramatically and mutual funds are going to be the best beneficiary. With smaller administrative costs more funds would be mobilized .A fund

manager must be ready to tackle the volatility and will have to maintain sufficient amount of investments which are high liquidity and low yielding investments to honor redemption.

- **Net based advertisements:** There will be more sites involved in ads and promotion of mutual funds. In the U.S. sites like AOL offer detailed research and financial details about the functioning of different funds and their performance statistics. a is witnessing a genesis in this area . There are many sites such as *indiainfoline.com* and *indiafn.com* that are doing something similar and providing advice to investors regarding their investments.

In the U.S. most mutual funds concentrate only on financial funds like equity and debt. Some like real estate funds and commodity funds also take an exposure to physical assets. The latter type of funds are preferred by corporate's who want to hedge their exposure to the commodities they deal with.

For instance, a cable manufacturer who needs 100 tons of Copper in the month of January could buy an equivalent amount of copper by investing in a copper fund. For Example, Permanent Portfolio Fund, a conservative U.S. based fund invests a fixed percentage of it's corpus in Gold, Silver, Swiss francs, specific stocks on various bourses around the world, short -term and long-term U.S. treasuries etc.

In U.S.A. apart from bullion funds there are copper funds, precious metal funds and real estate funds (investing in real estate and other related assets as well.).In India, the Canada based Dundee mutual fund is planning to launch a gold and a real estate fund before the year-end.

In developed countries like the U.S.A there are funds to satisfy everybody's requirement, but in India only the tip of the iceberg has been explored. In the near future India too will concentrate on financial as well as physical funds.

### **5.8.6. Regulatory Aspects**

#### **Schemes of a Mutual Fund**

The asset management company shall launch no scheme unless the trustees approve such scheme and a copy of the offer document has been filed with the Board.

Every mutual fund shall along with the offer document of each scheme pay filing fees.

The offer document shall contain disclosures which are adequate in order to enable the investors to make informed investment decision including the disclosure on maximum investments proposed to be made by the scheme in the listed securities of the group companies of the sponsor A close-ended scheme shall be fully redeemed at the end of the maturity period. "Unless a majority of the unit holders otherwise decide for its rollover by passing a resolution".

The mutual fund and asset management company shall be liable to refund the application money to the applicants,-

(i) If the mutual fund fails to receive the minimum subscription amount referred to in clause (a) of sub-regulation(1).

(ii) If the moneys received from the applicants for units are in excess of subscription as referred to in clause (b) of sub-regulation (1).

The asset management company shall issue to the applicant whose application has been accepted, unit certificates or a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than six weeks from the date of closure of the initial subscription list and or from the date of receipt of the request from the unit holders in any open ended scheme.

#### **Rules Regarding Advertisement:**

The offer document and advertisement materials shall not be misleading or contain any statement or opinion, which are incorrect or false.



**Investment Objectives And Valuation Policies:**

The price at which the units may be subscribed or sold and the price at which such units may at any time be repurchased by the mutual fund shall be made available to the investors.

**General Obligations:**

Every asset management company for each scheme shall keep and maintain proper books of accounts, records and documents, for each scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular give a true and fair view of the state of affairs of the fund and intimate to the Board the place where such books of accounts, records and documents are maintained.

The financial year for all the schemes shall end as of March 31 of each year. Every mutual fund or the asset management company shall prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule.

Every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.

**Procedure For Action In Case Of Default:**

On and from the date of the suspension of the certificate or the approval, as the case may be, the mutual fund, trustees or asset management company, shall cease to carry on any activity as a mutual fund, trustee or asset management company, during the period of suspension, and shall be subject to the directions of the Board with regard to any records, documents, or securities that may be in its custody or control, relating to its activities as mutual fund, trustees or asset management company.

**Restrictions on Investments:**

A mutual fund scheme shall not invest more than 15% of its NAV in debt instruments issued by a single issuer, which are rated not below investment

grade by a credit rating agency authorized to carry out such activity under the Act. Such investment limit may be extended to 20% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of asset management company.

A mutual fund scheme shall not invest more than 10% of its NAV in uncrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of asset management company.

No mutual fund under all its schemes should own more than ten per cent of any company's paid up capital carrying voting rights.

Such transfers are done at the prevailing market price for quoted instruments on spot basis. The securities so transferred shall be in conformity with the investment objective of the scheme to which such transfer has been made.

A scheme may invest in another scheme under the same asset management company or any other mutual fund without charging any fees, provided that aggregate inter scheme investment made by all schemes under the same management or in schemes under the management of any other asset management company shall not exceed 5% of the net asset value of the mutual fund.

The initial issue expenses in respect of any scheme may not exceed six per cent of the funds raised under that scheme.

Every mutual fund shall buy and sell securities on the basis of deliveries and shall in all cases of purchases, take delivery of relative securities and in all cases of sale, deliver the securities and shall in no case put itself in a position whereby it has to make short sale or carry forward transaction or engage in badla finance.

Every mutual fund shall, get the securities purchased or transferred in the name of the mutual fund on account of the concerned scheme, wherever investments are intended to be of long-term nature.

Pending deployment of funds of a scheme in securities in terms of investment objectives of the scheme a mutual fund can invest the funds of the scheme in short term deposits of scheduled commercial banks.

#### **5.8.7. Limitations of Mutual Funds:**

**Entry and exit costs:** Mutual funds are a victim of their own success. When a large body like a fund invests in shares, the concentrated buying or selling often results in adverse price movements ie at the time of buying, the fund ends up paying a higher price and while selling it realizes a lower price. This problem is especially severe in emerging markets like India, where, excluding a few stocks, even the stocks in the Sensex are not liquid, let alone stocks in the NSE 50 or the CRISIL 500. So, there is simply no way that a fund can beat the Sensex or any other index, if it blindly invests in the same stocks as those in the Sensex and in the same proportion. For obvious reasons, this problem is even more severe for funds investing in small capitalization stocks. However, given the large size of the debt market, excluding UTI, most debt funds do not face this problem

**Wait time before investment:** It takes time for a mutual fund to invest money. Unfortunately, most mutual funds receive money when markets are in a boom phase and investors are willing to try out mutual funds. Since it is difficult to invest all funds in one day, there is some money waiting to be invested. Further, there may be a time lag before investment opportunities are identified. This ensures that the fund under performs the index. For open-ended funds, there is the added problem of perpetually keeping some money in liquid assets to meet redemptions. The problem of impracticability of quick investments is likely to be reduced to some extent with the introduction of index futures.

**Fund management costs:** The costs of the fund management process are deducted from the fund. This includes marketing and initial costs deducted at the

time of entry itself, called "load". Then there is the annual asset management fee and expenses, together called the expense ratio. Usually, the former is not counted while measuring performance, while the latter is. A standard 2% expense ratio means that, everything else being equal, the fund manager underperforms the benchmark index by an equal amount.

**Cost of churn:** The portfolio of a fund does not remain constant. The extent to which the portfolio changes is a function of the style of the individual fund manager i.e whether he is a buy and hold type of manager or one who aggressively churns the fund. It is also dependent on the volatility of the fund size i.e whether the fund constantly receives fresh subscriptions and redemptions. Such portfolio changes have associated costs of brokerage, custody fees, registration fees etc. which lowers the portfolio return commensurately.

**Change of index composition:** World over, the indices keep changing to reflect changing market conditions. There is an inherent survivorship bias in this process, with the bad stocks weeded out and replaced by emerging blue chips. This is a severe problem in India with the Sensex having been changed twice in the last 5 years, with each change being quite substantial. Another reason for change index composition is Mergers & Acquisitions. The weight age of the shares of a particular company in the index changes if it acquires a large company not a part of the index.

**Tendency to take conformist decisions:** From the above points, it is quite clear that the only way a fund can beat the index is through investment of some part of its portfolio in some shares where it gets excellent returns, much more than the index. This will pull up the overall average return. In order to obtain such exceptional returns, the fund manager has to take a strong view and invest in some uncommon or unfancied investment options. Most people are unwilling to do that. They follow the principle "No fund manager ever got fired for investing in Hindustan Lever" i.e if something goes wrong with an unusual investment, the fund manager will be questioned but if anything goes wrong with the blue chip,

then you can always blame it on the "environment" or "uncontrollable factors" knowing fully well that there are many other fund managers who have made the same decision. Unfortunately, if the fund manager does the same thing as several others of his class, chances are that he will produce average results. This does not mean that if a fund manager takes "active" views and invests in heavily researched "uncommon" ideas, the fund will necessarily outperform the index. If the idea does not work, it will result in poor fund performance. But if no such view is taken, there is absolutely no chance that the fund will outperform the index.

**5.8.8. Activities**

1. Go though any business or stock marked to name of mutual Funds for atleast two names of mutual funds foe each type.

	Type of Mutual Fund	Indian Examples.
1.	.....	.....
2.	.....	.....
3.	.....	.....
4.	.....	.....
5.	.....	.....

2. Fix an appointment with the mutual funds dealer and observe the features and merits of popular manual funds.

	Name of Mutual Fund	Features	Merits
1.	.....	.....	.....
2.	.....	.....	.....
3.	.....	.....	.....
4.	.....	.....	.....
5.	.....	.....	.....

3. Meet your friends, who invested is mutual funds, and obtain from them the merits of the schemes in which they invested.

	Name of Mutual Funds	Merits
1.	.....	.....
2.	.....	.....
3.	.....	.....
4.	.....	.....

**5.8.9. Self Assessment Test:**

1. Define Mutual Fund? Explain its general features?
2. Write Short notes on :
  - a. Net Asset value.
  - b. Open – ended scheme
  - c. Close-ended scheme.
3. Why mutual funds failed in the market? Bring out its repercussions.

**5.11. FURTHER READINGS**

Khan, M.Y. “Financial Services” – Tata McGraw Hill Publishing Company Limited .

Ferrell , O.C. and Others, “Marketing Strategy Vikas Publishing House.