Industrial Economics
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CHAPTER 2
ORGANIZATION OF FIRMS

MEANING OF FIRM

- Firm can be defined as an organization that employs productive resources to obtain products and/or services which are offered in the market with the aim of making a profit.
- A few key words in this definition deserve further attention.
- First, all firms are organization but not all organizations are firms. An organization is a complex social system created by people to cooperate in the achievement of some goal.

MEANING OF FIRM

- For instance, political party is an organization but its goal is to contribute to positively transform society by means of collectively exerting political power.
- What distinguishes firm from other organization is the aim of obtaining a profit through selling products and services in the market.
- An organization is much wider term. There are a variety of legal types of organizations, including corporations, government and non-governmental organizations, political organization, international organization, armed forces, charities, not-for-profit corporations, partnerships,cooperatives and educational institutions.

TYPES OF FIRM

- There are several types of firms that differ from each other based on their ownership structures.
- 1. Individual or Sole proprietorship or sole traders
- 2. Partnership
- 3. Co-operative Society
- 4. Joint Stock company
- 5. Public or State undertakings

TYPES OF FIRM

- 1- **INDIVIDUAL OR SOLE PROPRIETORSHIP**
- Individual or Sole proprietorship is the oldest and simplest form of business organization.
- A sole proprietorship is a form of private enterprise that is owned, managed and controlled by one person, and consequently, that person is liable for all costs and obligations. This type of business is also called single ownership or single proprietorship.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- **Features of the Sole Proprietorship:**
- The main characteristics of Sole Proprietorship are as follows-
- I. Single ownership: Sole Proprietorship form of organization that is owned
- by individual.
- II. Individual Management and control: Such organization is managed and controlled by Sole Proprietor. Competent people can be employed for efficient management of such enterprise.
- Individual Financing: Such organization is finance mainly by the Sole Proprietor.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- IV. Individual Accountability: Sole Proprietor is sole beneficiary of the profits.
- He has to bear the losses, if any. In this sense, the Sole Proprietor and employed person are accountable to the Sole Proprietor.
- V. Unlimited Liability: The liability of Sole Proprietor is unlimited. In other words, if the business assets are not sufficient to meet the business liabilities, his private assets are to be used to discharge the business liabilities.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- VI. Minimum Government Regulation: There are minimum government regulations to set up such form of organization.
- For instance, we can start a fruit stall or a cycle /scooter/photocopier shop without much legal formalities.
- However, in some cases a license may be required to be obtained for example; to start a restaurant, a license from local authority is required.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- Advantages of Individual or Sole Proprietorship or Sole Traders:
- The advantages of sole proprietorship form of organization are as follows:
- 1) Simple Formation: It is very easy and simple to form sole proprietorship.
- It does not require legal sanction. There is no specific regulation which governs the formation of sole proprietorship. Anybody can start this type of business according to his capacity and ability.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- 2) Independence: In this type of business the owner is altogether independent.
- He can make any type of transaction as he like without any interference from any other person. There is no check on his approach toward his project.
- 3) Quick Decisions: As the sole proprietor does not require much consultation or approval, he takes quick decisions on various matters relating to business operations. This makes functioning of business simple and easy.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- 4) Complete Control: The proprietor in this type of business exercises full
- control over the functioning and working of the business.
- 5) Need of Small Capital: Sole Proprietor has the advantage of starting the business with a comparatively small amount of capital. Person who has small capital but high qualities of enterprise can easily start the business.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- Disadvantages of Individual or Sole Proprietorship or Sole Traders:
  Individual or Sole proprietorship has the following disadvantages-

- 1) Lack of Division of labour: Being a small business, there is less scope for division of labour so production cannot be done efficiently and rapidly. It remains confined to small scale.

- 2) Limited Financial Resources: The sole proprietor has limited capital and has limited capacity to raise funds because of limited personal assets.

- This limitation reduces the scope for expansion and growth of business.

INDIVIDUAL OR SOLE PROPRIETORSHIP

- 3) Limited Managerial Skill: The sole proprietor has limited managerial skill and need not possess expertise in all areas like production, finance and marketing. Limited managerial skill reduces the scope for efficient management, expansion and the growth of business.
- 4) High Cost of Production: Being a small scale production the proprietor cannot reap the benefits of the economies of large scale production. It results in the high cost of production and higher prices. All this makes an adverse effect on the demand for his products.

TYPES OF FIRM

- 2- PARTNERSHIP
- As a form of business organization, partnership has a much wider scope as compared to the individual proprietorship.
- When two or more than two persons join to start and run a business on the basis of their common and shared responsibility in the matter of profit or loss, it is called the partnership.
- Partnership is an association of persons who agree to combine their financial resources and managerial abilities to carry on a business and share the profits in an agreed ratio.

PARTNERSHIP

- Features of Partnership of Firms
- I. Two or More Persons: There must be at least two persons to form a partnership but all such persons must be competent to contract.
- II. Agreement: It is imperative that there be present an expressed or implied agreement to form a partnership.
- III. Profit Sharing: Unless specified otherwise, there must be a sharing of profits and losses. It should also be noted that sharing of profits forms as a prima facie evidence and not a conclusive evidence of the existence of a partnership.
- IV. Joint Ownership and Control: Firm is owned and controlled jointly by the partners since every partner has a right to take part in the management of the business.

PARTNERSHIP

- **Types of partners:**
- A person who deals or intends to deal with a firm must know who the partners are and to what extent each partner is liable. To ascertain the extent of partner's it becomes necessary to know the various types of partners.
- A) Actual or Ostensible: He takes an active part in the conduct of the business. He along with other partners is liable to the third parties for the entire firm. He must give public notice of his retirement.
- B) Sleeping or Dormant partner: He does not take an active part in the conduct of the business. He along with other partners is liable to third parties for all acts of the firm. He need not give public notice of his retirement.

PARTNERSHIP

- C) Nominal Partner: He lends his name to the firm without having any real interest in the firm. He neither contributes to the capital nor shares the profits or takes part in the conduct of the business of the firm.
- D) Partner in Profit Partner: He share the profits only and not losses. He along with other partners is liable to third parties for all act of the firm. He must give public notice of his retirement.

PARTNERSHIP

- **Advantages of Partnership:**
- Following are the advantages of partnership-
- 1) Easy formation- It is very easy and simple to form partnership. The essential elements required to form partnership are at least two persons having capacity to contract, an agreement lawful business, sharing of profit and mutual agency.
- 2) Careful Decisions: Under the partnership, decision is not taken by an individual but by all the partners after a great deal of discussion. It reduces the chances for wrong decisions.

PARTNERSHIP

- 3) Division of Work: This management of business is not done by a single person but it is divided among different partners. It creates division of work and they can make better supervision of the business.
- 4) More Capital: More capital can be invested than in case of individual proprietorship.
- 5) Division of Labour: The division of labour become easy under the partnership because of the large-scale production. Thus, these partners can reap the benefit of labour division also.

PARTNERSHIP

- Disadvantages of Partnership:
- Partnership has its demerits also, which are as follows-
- 1) Lack of Mutual Confidence: The success of partnership depends upon the mutual confidence of the partners. They may have mutual confidence at the start of business, but it may go on shaking and may even collapse one day.
- In the absence of mutual confidence, the business gets a set-back and may be closed down.
- 2) Difficult to Separate: No partner can sell his shares to others according to his wishes. Therefore, one cannot separate from the business without permission of other partners.

PARTNERSHIP

- 3) Delay in Decision: Sometimes partners do not agree with each other on a particular issue and the decision may not be reached for lack of consent.
- There is scope for misunderstanding and conflicts in the partner. Such conflicts may lead to delays in decision-making and may lead even to dissolution of the firm. When some partners adopt rigid attitudes, it becomes impossible to arrive at a commonly agreed decision. It makes unnecessary delay in decisions and the business adversely affected.
- 4) Lack of Responsibility: Under partnership, every partner is equally responsible in the business. It is generally said that 'every man's responsibility is no man's responsibility'. So, lack of responsibility is a hindrance in the way of the business prosperity.

TYPES OF FIRM

- 3- JOINT STOCK COMPANY:
- The term ‘company’ implies an association of number of persons formed for some common object or objects. Joint Stock Company is one of the most important forms of business organization of the modern age.
- It is an extended from of the partnership business. When a of Firms number of persons, who are unknown to each other, join together to invest their money in some common business, it is called the joint stock company.

JOINT STOCK COMPANY

- Features of Joint Stock Company-
- **A joint stock company has following features-**
- I. An Artificial Person Created by Law-
- A Company is called an artificial person because it does not take birth lime a natural person but forms in into distance through law. Being the creation of law, the company possesses only those properties which are, conferred upon it by memorandum of association.

JOINT STOCK COMPANY

- 2. Legal Existence-
- A Joint Stock Company has legal existence. The company stands as an individual. The company is a legal person and it can be sued upon as an individual in the court of law for any wrong deed or action or it can sue any person.

JOINT STOCK COMPANY

- 3. Limited Liability-
- The liability of every shareholder is limited to the extent of his shares. If the company fails the share-holders or owners are liable to lose only what they have paid for their share.

JOINT STOCK COMPANY

- 4. Democratic Management-
- A Joint Stock Company is managed by the Board of Directors which is elected by its shareholders through the democratic system of casting vote.
- 5. Collective Ownership-
- The Company is not owned by a single person but collectively by all the shareholders to the extent of their shares. A shareholder can neither withdraw his capital equivalent to his shares, nor can demand his shares.

JOINT STOCK COMPANY

- **Advantages of a Company-**
- The advantages of Joint Stock Company are as follows:
- 1) Limited Liability-
- Having limited liability of the owners, the person who fears risk may also invest capital in the business. The shareholders are not liable to pay anything more than the face value of their shares.

JOINT STOCK COMPANY

- 2) Large Capital-
- Unlike individual proprietorship or partnership a joint stock company can arrange capital in large quantity. It can obtain capital easily and even at a lower rate of interest by floating its shares in the market.
- 3) Large Scale of Production-
- The large-scale production can be established on the basis of the joint stock company. Thus, company can reap all the advantages of large scale production.

JOINT STOCK COMPANY

- 4) Long Life-
- The Company has long life or its of more permanent nature. It does not make any difference to the company if the death of a share-holder occurs or he sells his share to another person. The shareholders may change,but the company functions normally.

JOINT STOCK COMPANY

- 5- Easy to Increase Capital-
- It is quite easy for a joint stock company to raise more capital whenever required, by floating new shares and selling debentures in the market.

JOINT STOCK COMPANY

- Disadvantages of a Company-
- The disadvantages of Joint Stock Company are as follows-
- 1) Lengthy and Expensive Procedure for Formation-
- Formation of a company is required to be prepared and filled. It is expensive in the sense that heavy fees for the preparation of required documents and for registration is required to be paid.

JOINT STOCK COMPANY

- 2) More Government Regulations-
- A company is required to comply with various legal formalities at every stage of its working and to penalty for non-compliance of the legal requirement. it is required to spend considerable time and afford in complying with the various legal requirements.
- **3) Separation of Organization and Enterprise-** In the joint stock company, shareholders are the entrepreneurs and the paid managers are the organisers
- **4) Danger of Monopoly-** The joint stock company can create monopoly in the market. Sometimes a few companies producing similar goods from a union and create monopoly.

JOINT STOCK COMPANY

- **5) Delay in Decision-Making and Action-**
- For a company, decision making process is time consuming since all important decisions are taken by either the Board of Directors or shareholders in their meeting and it is difficult to arrange meeting all of sudden

TYPES OF FIRM

- 4- PUBLIC OR STATE UNDERTAKINGS
- Industrial and commercial undertakings owned and run by the government are known as public sector undertakings.

PUBLIC OR STATE UNDERTAKINGS

- **Advantages of Public or State undertakings-**

- The Public or State enterprises have assumed great importance in the modern times. They possess the following advantages-

- **1) Development of Backward areas-**Private enterprises cannot satisfy the development needs of the backward areas. Extension of public enterprise is essential for the economic reconstruction of the backward areas.

PUBLIC OR STATE UNDERTAKINGS

- **2) Public welfare-** The aim of public enterprises is not to earn profits, but the social or public welfare which promotes national interest. The enterprises which do not give direct profit but are essential for the public welfare are run as the state enterprises, e.g. power projects or construction of dam and roads.

PUBLIC OR STATE UNDERTAKINGS

- **3) Development of Heavy and Basic Industries-**Private enterprise generally hesitate to participate in capital intensive investments. For instance, iron and steel plants, fertilizer plant, etc., therefore the public enterprise come to help in the development of heavy and basic industries.

PUBLIC OR STATE UNDERTAKINGS

- **4) Reasonable Prices-** In the private sector, capitalists from monopolies charge higher prices but the public enterprises produce generally of better quality goods and sell them reasonable prices.