UNIT – I
BUSINESS CONCEPTS AND FORMS OF BUSINESS ORGANISATION

INTRODUCTION TO BUSINESS

All human beings, wherever they may be, require different types of goods and services to satisfy their needs. The necessity of supplying goods and services has led to certain activities being undertaken by people to produce and sell what is needed by others. Business is a major economic activity in all modern societies concerned as it is concerned with the production and sale of goods and services required by people. The purpose behind most business activities is to earn money by meeting people's demands for goods and services. Business is central to our lives. Although our lives are influenced by many other institutions in modern society, such as schools, colleges, hospitals, political parties and religious bodies, business has a major influence on our daily lives. It, therefore, becomes important that we understand the concept, nature and purpose of business.

Historically, Trade and commerce have played a vital role in making India to evolve as a major actor in the economic world in ancient times. They are the mainstay of the economy of ancient India carried out by water and land. The ancient period was marked by substantial commercial activities and urban development. Political economy and military security during ancient times united most of the Indian subcontinent and trade regulations were carefully planned. There were diverse types of coins and weighing practices which used to vary from place to place with the help of money changers and by resorting to certain commonly accepted weights and measures.

Indigenous Banking System

As economic life progressed, metals began to supplement other commodities as money because of its durability and divisibility. As money served as a medium of exchange, the introduction of metallic money and its use accelerated economic activities. Indigenous banking system played a prominent role in lending money and financing domestic and foreign trade with currency and letter of credit. People began to deposit precious metals with lending individuals functioning as bankers or Seths. Thus, money became an instrument for supplying the manufacturers with a means of producing more goods.

Rise of Intermediaries

Intermediaries played a prominent role in the promotion of trade. They provided considerable financial security to the manufacturers by assuming responsibility for the risks involved, especially in foreign trade. It comprised commission agents, brokers and distributors both for wholesale and retail goods. An expanding trade brought in huge amounts of silver bullion into Asia and a large share of that bullion gravitated towards India.

The emergence of credit transactions and availability of loans and advances enhanced commercial operations. The Indian subcontinent enjoyed the fruits of favourable balance of trade, where exports exceeded imports with large margins and the indigenous banking system benefitted the manufacturers, traders and merchants with additional capital funds for expansion and development. Commercial and Industrial banks later evolved to finance trade and commerce and agricultural banks to provide both short-and long-term loans to finance agriculturists.

Transportation

Transport by land and water was popular in the ancient times. Trade was maintained by both land and sea. Roads as a means of communication had assumed key importance in the entire process of growth, particularly of the inland trade and for trade over land. Trade routes were structurally wide and suitable for speed and safety. Maritime trade was another important branch of global trade network.

Merchant Corporations

The merchant community were autonomous corporations formed to protect the interests of the traders. These corporations, organised on formal basis, framed their own rules of membership and professional code of conduct, which even kings were supposed to accept and respect. Trade and industry taxes were major source of revenue. Traders had to pay octroi duties that were levied on most of the imported articles at varying rates either in cash or in kind. Customs duties varied according to the commodities. Tariffs varied from province to province. The ferry tax was another source of income generation. It had to be paid for passengers, goods, cattle and carts. The right to receive the labour tax was usually transferred to the local bodies. The commercial activity, thus, enabled big merchants to gain power in the society.

CONCEPT OF BUSINESS

The term business is derived from the word 'busy'. Thus, business means being busy. However, in a specific sense, business refers to an occupation in which people regularly engage in activities related to purchase, production and/or sale of goods and services with a view to earning profits. The activity may consist of production or purchase of goods for sale, or exchange of goods or supply of services to satisfy the needs of other people. In every society, people undertake various activities to satisfy their needs.

These activities may be broadly classified into two groups, viz., economic and non-economic activities.

- **Economic activities** are those by which we can earn our livelihood. For example, a worker working in a factory, a doctor operating in his clinic, a manager working in an office are doing so to earn their livelihoods and are, therefore, engaged in an economic activity. Economic activities may be further divided into three categories, namely business, profession and employment. Business may be defined as an economic activity involving the production and sale of goods and services undertaken with a motive of earning profit by satisfying human needs in society.
- **Non-economic activities** are performed out of love, sympathy, sentiment, patriotism, etc. For example, a housewife cooking food for her family, or a boy helping an old man cross the road are performing non-economic activities since they are doing so out of love or sympathy.

CHARACTERISTICS OF BUSINESS ACTIVITIES

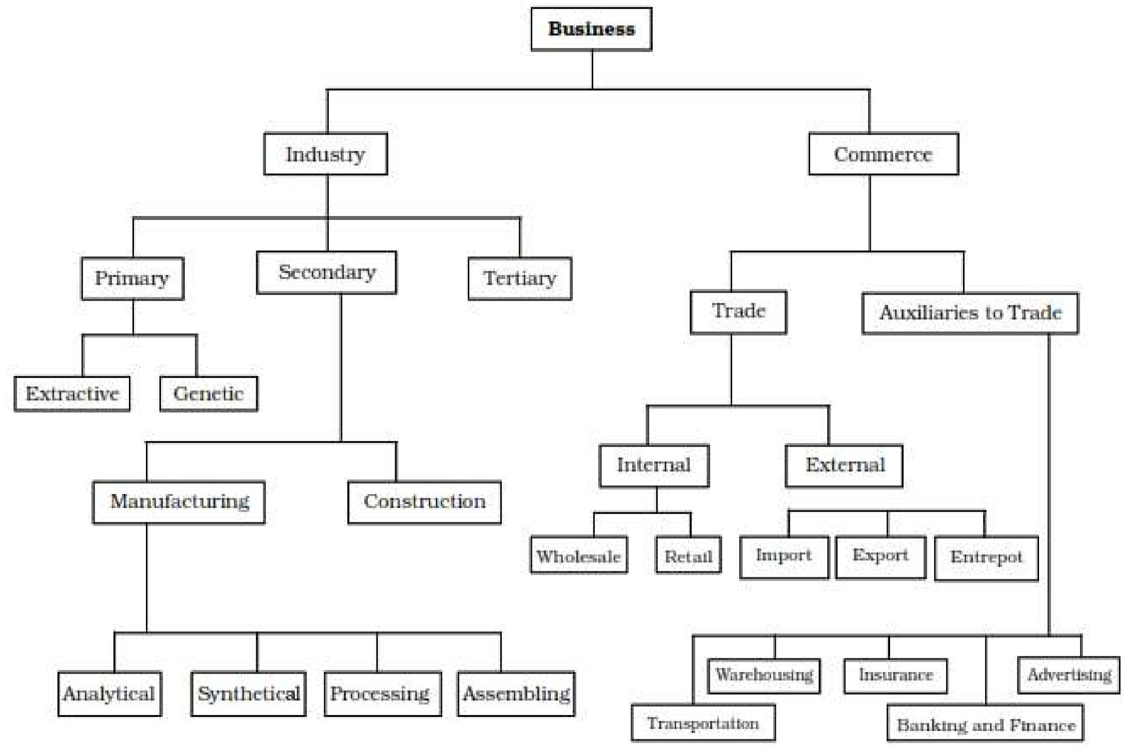
The characteristics of business activities are:

1. An economic activity
2. Production or procurement of goods and services
3. Sale or exchange of goods and services
4. Dealings in goods and services on a regular basis
5. Profit earning
6. Uncertainty of return
7. Element of risk

1. **An economic activity:** Business is considered to be an economic activity because it is undertaken with the objective of earning money or livelihood and not out of love, affection, sympathy or any other emotion. This activity can be undertaken either on small and individual level, or on large scale in a more formal and organised level.
2. **Production or procurement of goods and services:** Before goods are offered to people for consumption, these must be either produced or procured by business enterprises. Thus, every business enterprise either manufactures the goods it deals in or acquires them from producers, to be further sold to consumers or users. Goods may consist of consumable items of daily use, such as sugar, ghee, pen, notebook, etc., or capital goods, like machinery, furniture, etc., Services may include facilities offered to consumers, business firms and organisations in the form of transportation, banking, electricity, etc.
3. **Sale or exchange of goods and services:** Directly or indirectly, business involves transfer or exchange of goods and services for value between the seller and the buyer. If goods are produced not for the purpose of sale but for personal consumption, it cannot be called a business activity. Cooking food at home for the family is not business, but cooking food and selling it to others in a restaurant is business.
4. **Dealings in goods and services on a regular basis:** Business involves dealings in goods or services on a regular basis. One single transaction of sale or purchase, therefore, does not constitute business. Thus, for example, if a person sells domestic radio set even at a profit, it will not be considered a business activity. But if they sell radio sets regularly either through a shop or from his/her residence, it will be regarded as a business activity.
5. **Profit earning:** The main purpose of business is to earn income by way of profit. No business can survive for long without profit. That is why, businessmen make all possible efforts to maximise profits, by increasing the volume of sales or reducing costs.
6. **Uncertainty of return:** Every business invests money (capital) to run its activities with the objective of earning profit. But it is not certain as to what amount of profit will be earned in a given period. Every business invests money (capital) to run its activities with the objective of earning profit. But it is not certain as to what amount of profit will be earned. Also, there is always a possibility of losses being incurred, dispite the best efforts put into the business.
7. **Element of risk:** Risk is the uncertainty associated with an exposure to loss. It is caused by some unfavourable or undesirable events. Risks are related with factors, like changes in consumer taste and fashion, changes in method of production, strike or lockout at workplace, increased competition in market, fire, theft, accidents, natural calamities, etc. No business can altogether do away with risks.

CLASSIFICATION OF BUSINESS ACTIVITIES

Business activities may be classified into two broad categories - industry and commerce. Industry is concerned with the production or processing of goods and materials. Commerce includes all those activities, which are necessary for facilitating the exchange of goods and services. On the basis of these two categories, business firms can be classified into industrial and commercial enterprises.



INDUSTRY

Industry refers to economic activities, which are connected with conversion of resources into useful goods. Generally, the term industry is used for activities in which mechanical appliances and technical skills are involved. These include activities relating to producing or processing of goods, as well as, breeding and raising of animals. The term industry is also used to mean groups of firms producing similar or related goods. For example, cotton textile industry refers to all manufacturing units producing textile goods from cotton. Similarly, electronic industry, services, like banking industry, insurance industry, etc. Industries may be divided into three broad categories viz., primary, secondary and tertiary.

1. **Primary Industries:** Primary industries include the activities related with the extraction and production of natural resources and reproduction and development of living organisms, plants, etc. These are divided as:
   a. **Extractive industries:** These industries extract or draw products from natural sources. It includes farming, mining, lumbering, hunting and fishing operations.
   b. **Genetic industries:** These industries are engaged in breeding plants and animals for their use in further reproduction.

2. **Secondary Industries:** Secondary industries are concerned with using materials, which have already been extracted at the primary state. These industries process such materials to produce goods for final consumption or for further processing by other industrial units. For example, mining of iron ore is a primary industry, but manufacturing of steel by way of further processing of raw irons is a secondary industry. Secondary industries may be further divided as manufacturing and construction industries.
   a. **Manufacturing industries:** These industries are engaged in producing goods through processing of raw materials and, thus, creating form utilities/ finished products. Manufacturing industries may be further divided into four categories on the basis of method of operation for production.
      - ✓ **Analytical industry** which analyses and separates different elements from the same materials, as in the case of oil refinery.
      - ✓ **Synthetical industry** which combines various ingredients into a new product, as in the case of cement.
      - ✓ **Processing industry** which involves successive stages for manufacturing finished products, as in the case of sugar and paper.
      - ✓ **Assembling industry** which assembles different component parts to make a new product, as in the case of television, car, computer, etc.
   b. **Construction industries:** These industries are involved in the construction of buildings, dams, bridges, roads as well as tunnels and canals. Engineering and architectural skills are an important part in construction industries.

3. **Tertiary Industries**: These are concerned with providing support services to primary and secondary industries as well as activities relating to trade. These industries provide service facilities. As business activities, these may be considered part of commerce because as auxiliaries to trade these activities assist trade. Included in this category are transport, banking, insurance, warehousing, communication, packaging and advertising.

COMMERCE

Commerce provides the necessary link between producers and consumers. It embraces all those activities, which are necessary for maintaining a free flow of goods and services. Thus, all activities involving the removal of hindrances (persons, place, time, risk, finance, etc.) in the process of exchange are included in commerce. Commerce includes two types of activities, viz., (i) trade and (ii) auxiliaries to trade.

1. **Trade**: Trade refers to sale, transfer or exchange of goods. It helps in making the goods produced available to the consumers or end users. Businessmen are engaged in trading activities to make the goods available to consumers in different markets. Trade can be classified into two broad categories viz., Internal and External.
   a. **Internal, domestic or home trade** is concerned with the buying and selling of goods and services within the geographical boundaries of a country. This may further be divided into wholesale and retail trade. When goods are purchased and sold in large quantities for consumption it is referred to as wholesale trade. When goods are purchased and sold in comparatively smaller quantities, for final consumption it is referred to as retail trade.

b. **External or foreign trade** consists of the exchange of goods and services between persons or organisations operating in two or more countries. If goods are purchased from another country, it is called import trade. If they are sold to other countries, it is known as export trade. When goods are imported for export to other countries, it is known as entrepot trade.

2. **Auxiliaries to Trade:** Activities which are meant for assisting trade are known as auxiliaries to trade. These activities are generally referred to as services because these are in the nature of facilitating the activities relating to industry and trade. For example: Transport, banking, insurance, warehousing, and advertising are regarded as auxiliaries to trade, i.e., activities playing a supportive role. In fact, these activities support not only trade, but also industry and, hence, the entire business activity. Auxiliaries are an integral part of commerce in particular and business activity in general. These activities help in removing various hindrances which arise in connection with the production and distribution of goods. Transport facilitates movement of goods from one place to another. Banking provides financial assistance to the manufacturer and trader. Insurance covers various kinds of business risks. Warehousing creates time utility by way of storage facilities. Advertising provides information to the consumers. In other words, these activities facilitate movement, storage, financing, risk coverage and sales promotion of goods.

OBJECTIVES OF BUSINESS

An objective is the starting point of business. Every business is directed to the achievement of certain objectives. Objectives refer to all that the business people want to get in return for what they do. It is generally believed that business activity is carried out only for profit. Business persons themselves proclaim that their primary objective is produce or distribute goods or services for profit. Every business is said to be an attempt on the part of business people to get more than what has been spent or invested, or in other words, to earn profit which is the excess of revenue over cost. However, it is being increasingly realised nowadays that business enterprises are part of the society and need to fulfill several objectives, including social responsibility, to survive and prosper in the long run.

Profit may be regarded as an essential objective of business for various reasons:

– it is a source of income for business persons,
– it can be a source of finance for meeting expansion requirements of business,
– It indicates the efficient working of business,
– it can be taken as the society's approval of the utility of business, and
– it builds the reputation of a business enterprise.

Other Objectives of Business

1. **Market standing:** Market standing refers to the position of an enterprise in relation to its competitors.
2. **Innovation:** Innovation is the introduction of new ideas or methods in the way something is done or made.

3. **Productivity:** Productivity is ascertained by comparing the value of output with the value of inputs.
4. **Physical and financial resources:** Any business requires physical resources, like plants, machines, offices, etc., and financial resources, i.e., funds to be able to produce and supply goods and services to its customers.
5. **Earning profits:** One of the objectives of business is to earn profits on the capital employed. Every business must earn a reasonable profit which is so important for its survival and growth.
6. **Manager performance and development:** Business enterprises need managers to conduct and coordinate business activity.
7. **Worker performance and attitude:** Workers' performance and attitudes determine their contribution towards productivity and profitability of any enterprise.
8. **Social responsibility:** It refers to the obligation of business firms to contribute resources for solving social problems and work in a socially desirable manner.

FORMS OF BUSINESS ORGANIZATION

Business organisation refers to all necessary arrangements required to conduct a business. It refers to all those steps that need to be undertaken for establishing relationship between men, material and machinery to carry on business efficiency for earning profits. For example take a rice mill. First, the owner will have to acquire a land, construct a building, buy machines and install them, employ labour to work, buy paddy and then process the paddy to produce rice that will be sold to the customers. Thus, to produce rice from paddy you need to assemble resources like land, building, machinery, labour etc., and put these resources together in action in a systematic way. Then only it becomes possible to produce rice and sell it to the customers, and earn profit.

Thus, to carry out any business and achieve its objective of earning profit it is required to bring together all the resources and put them into action in a systematic way, and coordinate and control these activities properly. This arrangement is known as business organisation. The conduct of business, its control, acquisition of capital, distribution of profit, legal formalities, etc., depend on the form of organization.

In India the following are the different types of formation of business organisations.

- Sole Proprietorship
- Partnership firm
- Joint Stock Company
- Joint Hindu Family firm
- Co-operative society
- Public Enterprises

FEATURES OF BUSINESS ORGANIZATION

There are certain parameters against which we can evaluate each of the available forms of business organizations:

1. **Easy to start and easy to close:** The form of business organization should be such that it should be easy to close. There should not be hassles or long procedures in the process of setting up business or closing the same.

2. **Division of labour:** There should be possibility to divide the work among the available owners.
3. **Large amount of resources:** Large volume of business requires large volume of resources. Some forms of business organization do not permit to raise larger resources. Select the one which permits to mobilize the large resources.
4. **Liability:** The liability of the owners should be limited to the extent of money invested in business. It is better if their personal properties are not brought into business to make up the losses of the business.
5. **Secrecy:** The form of business organization you select should be such that it should permit to take care of the business secrets. The business units are still surviving only because they could successfully guard their business secrets.
6. **Ownership, Management and control:** If ownership, management and control are in the hands of one or a small group of persons, communication will be effective and coordination will be easier.
7. **Transfer of ownership:** There should be simple procedures to transfer the ownership to the next legal heir or any other individual.
8. **Continuity:** The business should continue forever and ever irrespective of the uncertainties in future.
9. **Quick decision-making:** Select such a form of business organization, which permits you to take decisions quickly and promptly. Delay in decisions may invalidate the relevance of the decisions.
10. **Personal contact with customer:** Most of the times, customers give us clues to improve business. So, choose such a form, which keeps you close to the customers.
11. **Flexibility:** In times of rough weather, there should be enough flexibility to shift from one business to the other. The lesser the funds committed in a particular business, the better it is.
12. **Taxation:** When a firm earns more profit means it has to pay more taxes. Choose such a firm, which permits to pay low tax.

SOLE TRADER

The sole trader is the simplest, oldest and natural form of business organization. It is also called ***Sole Proprietorship***. 'Sole' means one. 'Sole trader' implies that there is only one trader who is the owner of the business.

It is a one-man form of organization wherein the trader assumes all the risk of ownership carrying out the business with his own capital, skill and intelligence. He has total freedom and flexibility. He can take his own decisions. He can choose or drop a particular product or business based on its merits. He need not discuss this with anybody. This form of organization is popular all over the world.

Ex: Restaurants, Supermarkets, pan shops, medical shops, etc.

Features:

1. It is easy to start a business under this form and also easy to close.
2. He introduces his own capital. Sometimes, he may borrow, if necessary
3. He enjoys all the profits and in case of loss, he alone suffers.

4. He has unlimited liability which implies that his liability extends to his personal properties in case of loss.
5. He has a high degree of flexibility to shift from one business to the other.
6. Business secretes can be guarded well.
7. There is no continuity. The business comes to a close with the death, illness or insanity of the sole trader. Unless, the legal heirs show interest to continue the business, the business cannot be restored.
8. He can be directly in touch with the customers.
9. He can take decisions very fast and implement them promptly.
10. Rates of taxes i.e., income tax and so on are comparatively very low.

Advantages:

The following are the advantages of the sole trader from of business organization:

1. **Easy to start and easy to close**: Formation of a sole trader form of organization is relatively easy even closing the business is easy.
2. **Direct contact with customers:** Based on the tastes and preferences of the customers the stocks can be maintained.
3. **Prompt decision-making:** To improve the quality of services to the customers, he can take any decision and implement the same promptly. He is the boss and he is responsible for his business decisions relating to growth or expansion.
4. **Flexibility:** Based on the profitability, the trader can decide to continue or change the business. He has the flexibility to shift from one business to other.
5. **Secrecy:** Business secrets can well be maintained because there is only one trader.
6. **Low rate of taxation:** The rate of income tax for sole traders is relatively very low.
7. **Total Control:** The ownership, management and control are in the hands of the sole trader and hence it is easy to maintain the hold on business.
8. **Interference from government:** Except in matters relating to public interest, government does not interfere in the business matters of the sole trader. The sole trader is free to fix price for his products/services if he enjoys monopoly market.
9. **Transferability:** The legal heirs of the sole trader may take the possession of the business.
10. **Direct motivation:** If there are profits, all the profits belong to the trader himself. In other words. If he works harder, he will get more profits. This is the direct motivating factor. At the same time, if he does not take active interest, he may stand to lose badly also.

Disadvantages:

The following are the disadvantages of sole trader form:

1. **Unlimited liability:** The liability of the sole trader is unlimited. It means that the sole trader has to bring his personal property to clear off the loans of his business. From the legal point of view, he is not different from his business.
2. **Limited amounts of capital:** The resources a sole trader can mobilize cannot be very large and hence this naturally sets a limit for the scale of operations.
3. **No division of labour:** All the work related to different functions such as marketing, production, finance, labour and so on has to be taken care of by the sole trader himself. There is nobody else to take his burden.

4. **Uncertainty:** There is no continuity in the duration of the business. On the death, insanity of insolvency the business may be come to an end.
5. **No growth and expansion:** This from is suitable for only small size, one-man-show type of organizations. This may not really work out for growing and expanding organizations.
6. **More competition:** Because it is easy to set up a small business, there is a high degree of competition among the small businessmen and a few who are good in taking care of customer requirements along can service.
7. **Low bargaining power:** The sole trader is the in the receiving end in terms of loans or supply of raw materials. He may have to compromise many times regarding the terms and conditions of purchase of materials or borrowing loans from the finance houses or banks.

PARTNERSHIP

Partnership is an improved from of sole trader in certain respects. Where there are like-minded persons with resources, they can come together to do the business and share the profits/losses of the business in an agreed ratio. Persons who have entered into such an agreement are individually called 'Partners' and collectively called 'firm'. The relationship among partners is called a partnership.

Indian Partnership Act, 1932 defines "Partnership as the relationship between two or more persons who agree to share the profits of the business carried on by all or any one of them acting for all."

Features:

1. **Relationship:** Partnership is a relationship among persons. It is relationship resulting out of an agreement.
2. **Two or more persons:** There should be two or more number of persons.
3. **There should be a business**: Business should be conducted.
4. **Agreement:** Persons should agree to share the profits/losses of the business
5. **Carried on by all or any one of them acting for all:** The business can be carried on by all or any one of the persons acting for all. This means that the business can be carried on by one person who is the agent for all other persons. All the partners are agents and the 'partnership' is their principal.
6. **Unlimited liability:** The liability of the partners is unlimited. The partnership and partners, in the eye of law, and not different but one and the same. Hence, the partners have to bring their personal assets to clear the losses of the firm, if any.
7. **Number of partners:** According to the Indian Partnership Act, the minimum number of partners should be two and the maximum is 10 partners is case of banking business and 20 in case of non-banking business.
8. **Division of labour:** Because there are more than two persons, the work can be divided among the partners based on their aptitude.
9. **Personal contact with customers:** The partners can continuously be in touch with the customers to monitor their requirements.
10. **Flexibility:** All the partners are likeminded persons and hence they can take any decision relating to business.

11. **Transferability of share/interest:** The partners cannot transfer their share/interest in partnership in the firm to others without the consent of the other partners.
12. **Taxation:** The profits of partnership and individual incomes of partners are taxed separately.
13. **Dissolution:** The closure of partnership is called dissolution. When any of the partners die, becomes insolvent, the partnership can be dissolved or restart with a new name.

Advantages:

The following are the advantages of the partnership from:

1. **Easy to form:** Once there is a group of like-minded persons and good business proposal, it is easy to start and register a partnership.
2. **Availability of larger amount of capital:** More amount of capital can be raised from more number of partners.
3. **Division of labour:** The different partners come with varied backgrounds and skills. This facilities division of labour.
4. **Flexibility:** The partners are free to change their decisions, add or drop a particular product or start a new business or close the present one and so on.
5. **Personal contact with customers**: There is scope to keep close monitoring with customers' requirements by keeping one of the partners in charge of sales and marketing. Necessary changes can be initiated based on the merits of the proposals from the customers.
6. **Quick and prompt action:** If there is consensus among partners, it is enough to implement any decision and initiate prompt action. Sometimes, it may more time for the partners on strategic issues to reach consensus.
7. **Tax rate:** When compared to a company form, the tax rate is low.

Disadvantages:

1. **Formation of partnership is difficult:** Only like-minded persons can start a partnership. It is sarcastically said,' it is easy to find a life partner, but not a business partner'.
2. **Liability:** The partners have joint and several liabilities beside unlimited liability. Joint and several liability puts additional burden on the partners, which means that even the personal properties of the partner or partners can be attached. Even when all but one partner become insolvent, the solvent partner has to bear the entire burden of business loss.
3. **Lack of harmony or cohesiveness:** It is likely that partners may not, most often work as a group with cohesiveness. This result in mutual conflicts, an attitude of suspicion and crisis of confidence. Lack of harmony results in delay in decisions and paralyses the entire operations.
4. **Instability:** The partnership form is known for its instability. The firm may be dissolved on death, insolvency or insanity of any of the partners.
5. **Limited growth:** The resources when compared to sole trader, a partnership may raise little more. But when compare to the other forms such as a company, resources raised in this form of organization are limited.
6. **High tax rate:** When compared to the sole trader the tax rate is higher.
7. **Lack of Public confidence:** Though registration of the firm under the Indian Partnership Act is a solution of such problem, this cannot revive public confidence into this form of

organization overnight. The partnership can create confidence in other only with their performance.

Partnership Deed:

The written agreement among the partners is called 'Partnership Deed'. It contains the terms and conditions governing the working of partnership. The following are contents of the partnership deed:

1. Names and addresses of the firm and partners.
2. Nature of the business proposed.
3. Duration of the business.
4. Amount of capital and the ratio of contribution by each of the partners.
5. Their profit-sharing ratio (this is used for sharing losses also).
6. Rate of interest charged on capital contributed, loans taken from the partnership and the amounts drawn, by the partners from their respective capital balances.
7. The amount of salary or commission payable to any partner.
8. Procedure to value good will of the firm at the time of admission of a new partner, retirement of death of a partner.
9. Allocation of responsibilities of the partners in the firm.
10. Procedure for dissolution of the firm.
11. Name of the arbitrator to whom the disputes, can be referred for settlement.
12. Special rights, obligations and liabilities of partners(s), if any.

Kinds of Partners:

1. **Active Partner:** Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.
2. **Sleeping (Dormant partner):** Sleeping partners are those who do not take active part in the management of the business. Such partners only contribute capital in the firm and are bound by the activities of other partners. However, they share in the profits and losses of the business.
3. **Secret partner:** A secret partner is one whose association with the firm is unknown to the general public. He contributes to the capital of the firm, takes part in the management, shares its profits and losses, and has unlimited liability towards the creditors.
4. **Partner by Estoppel:** A person, who behaves in the public in such a way as to give an impression that he/she is a partner of the firm, is called 'partner by estoppel'. Such partners are not entitled to share the profits of the firm, but are fully liable if somebody suffers because of his/her false representation.
5. **Partner by Holding out:** If a partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as 'Partner by Holding out'. Such partners are not entitled to profits but are fully liable as regards the firm's debts. However, the third parties should prove they entered into contract with the firm in the belief that he is the partner of the firm.
6. **Nominal Partner:** Nominal partner is partner just for namesake. He allows the firm to use their name as partner. They neither invest any capital nor participate in the day-to-day operations. Normally, the nominal partners are those who have good business

connections, and are well places in the society. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm.

7. **Minor Partner (Partners in Profits):** A person who shares the profits of the business without being liable for the losses is known as partner in profits. This is applicable only to the 'Minors'. A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, he cannot become partner of a firm. He may, however, be admitted to the benefits of an existing partnership and their liability is limited to their capital contribution.

Suitability of Partnership Form of Business:

In a partnership firm, persons having different ability, managerial skill or expertise can join hands to form a partnership form of business. It is also considered suitable where capital requirement is of a medium size. Small business such as retail and wholesale trade, professional services, medium sized mercantile houses and small manufacturing units. Thus, business activities like construction, providing legal services, medical services etc. can be successfully run under this form of business organisation.

JOINT STOCK COMPANY

The Joint Stock Company emerges from the limitations of partnership such as joint and several liability, unlimited liability, limited resources and uncertain duration and so on. Normally, to take part in a business, it may need large money and we cannot foretell the fate of business. It is not literally possible to get into business with little money. The main principle is to provide opportunity to take part in business with a low investment as possible say Rs.1000. Here the capital is divided in to certain units. Each unit is called a share. The price of each share is so low, that a common man can afford.

The word 'company' has a Latin origin, 'com' means 'come together' and 'pany' means 'bread', Joint Stock Company means, people come together to earn their livelihood by investing in the stock of company jointly.

Example: Tata Iron & Steel Co. Limited, Hindustan Lever Limited, Reliance Industries Limited, Steel Authority of India Limited, Ponds India Limited, etc.

Definition:

Indian Companies Act 1956 defines a company as "A company formed and registered under the act or an existing company."

Lord Justice Lindley explained the concept of the joint stock company form of organization as 'an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose.

Features:

This definition brings out the following features of the company:

1. **Artificial person:** The Company has no form or shape. It is an artificial person created by law. It is intangible, invisible and existing only, in the eyes of law.
2. **Separate legal existence**: It has an independence existence, it separate from its members. It can acquire the assets. It can borrow for the company. It can sue other if they are in

default in payment of dues, breach of contract with it, if any. Similarly, outsiders for any claim can sue it.

3. **Voluntary association of persons**: The Company is an association of voluntary association of persons who want to carry on business for profit. To carry on business, they need capital. So they invest in the share capital of the company.
4. **Capital is divided into shares**: The total capital is divided into a certain number of units. Each unit is called a share. The price of each share is priced so low that every investor would like to invest in the company. The companies promoted by promoters of good standing are likely to attract huge resources.
5. **Limited Liability**: The shareholders have limited liability i.e., liability limited to the face value of the shares held by him. In other words, the liability of a shareholder is restricted to the extent of his contribution to the share capital of the company. The shareholder need not pay anything, even in times of loss for the company, other than his contribution to the share capital.
6. **Transferability of shares**: In the company form of organization, the shares can be transferred from one person to the other. A shareholder of a public company can cell sell his holding of shares at his will. A private company restricts the transferability of the shares.
7. **Perpetual succession**: 'Members may come and members may go, but the company continues forever and ever'. A company has uninterrupted existence because of the right given to the shareholders to transfer the shares.
8. **Common Seal**: As the company is an artificial person created by law has no physical form, it cannot sign its name on a paper; so, it has a common seal on which its name is engraved. The common seal should affix every document or contract; otherwise the company is not bound by such a document or contract.
9. **Ownership and Management separated**: The shareholders are spread over the country, and sometimes, they are from different parts of the world. To facilitate administration, the shareholders elect some among themselves or the promoters of the company as directors to a Board, which looks after the management of the business. The Board recruits the managers and employees at different levels in the management.
10. **Winding up**: Winding up refers to the putting an end to the company. Because law creates it, only law can put an end to it in special circumstances such as representation from creditors of financial institutions, or shareholders against the company that their interests are not safeguarded. The company is not affected by the death or insolvency of any of its members.
11. **The name of the company ends with 'limited'**: it is necessary that the name of the company ends with limited (Ltd.) to give an indication to the outsiders that they are dealing with the company with limited liability and they should be careful about the liability aspect of their transactions with the company.

Advantages:

The following are the advantages of a joint Stock Company

1. **Mobilization of larger resources:** A joint stock company provides opportunity for the investors to invest, even small sums, in the capital of large companies. The facilities rising of larger resources.

2. **Separate legal entity:** The Company has separate legal entity. It is registered under Indian Companies Act, 1956.
3. **Limited liability:** The shareholder has limited liability in respect of the shares held by him. In no case, does his liability exceed more than the face value of the shares allotted to him.
4. **Transferability of shares:** The shares can be transferred to others. However, the private company shares cannot be transferred.
5. **Liquidity of investments**: By providing the transferability of shares, shares can be converted into cash.
6. **Democracy in management**: The shareholders elect the directors in a democratic way in the general body meetings. The shareholders are free to make any proposals, question the practice of the management, suggest the possible remedial measures.
7. **Continued existence**: The Company has perpetual succession. It has no natural end. It continues forever and ever unless law put an end to it.
8. **Institutional confidence**: Financial Institutions prefer to deal with companies in view of their professionalism and financial strengths.
9. **Professional management**: With the larger funds at its disposal, the Board of Directors recruits competent and professional managers to handle the affairs of the company in a professional manner.
10. **Growth and Expansion**: With large resources and professional management, the company can earn good returns on its operations, build good amount of reserves and further consider the proposals for growth and expansion.

Disadvantages:

1. **Formation of company is a long procedure**: Promoting a joint stock company involves a long-drawn procedure. It is expensive and involves large number of legal formalities.
2. **High degree of government interference**: The government brings out a number of rules and regulations governing the internal conduct of the operations of a company such as meetings, voting, audit and so on, and any violation of these rules results into statutory lapses, punishable under the companies act.
3. **Inordinate delays in decision-making**: As the size of the organization grows, the number of levels in organization also increases in the name of specialization. The more the number of levels, the more is the delay in decision-making.
4. **Lack of initiative**: In most of the cases, the employees of the company at different levels show slack in their personal initiative with the result, the opportunities once missed do not recur and the company loses the revenue.
5. **Lack of responsibility and commitment:** In some cases, the managers at different levels are afraid to take risk and more worried about their jobs rather than the huge funds invested in the capital of the company.
6. **Higher Taxes:** The rate of income tax is very high when compared to the other forms of organizations.

FORMATION OF JOINT STOCK COMPANY

It is not easy to form a company. A lengthy process is to be followed in order to ensure that a company is formed. But a company is an artificial person created by law someone has to get an idea about the company formation, who will also decide about the size, kind of company etc., of the company. Those who perform these functions are called as "promoters". This process is called as "promotion of a company". The promoters have to file the following documents, along with necessary fee, with a registrar of joint stock companies.

There are two stages in the formation of a joint stock company. They are:

1. Certificates of Incorporation
2. Certificate of commencement of Business

1. **To obtain Certificates of Incorporation:**

   The certificate of Incorporation is just like a 'date of birth' certificate. It certifies that a company is born on a particular day. The persons who conceive the idea of starting a company and who organize the necessary initial resources are called promoters. The promoters have to file the following documents, along with necessary fee, with a registrar of joint stock companies to obtain certificate of incorporation:

   (a) **Memorandum of Association**: The Memorandum of Association is also called the charter of the company. It outlines the relations of the company with the outsiders. If furnishes all its details in six clause such as:

   i. *Name clause:* This clause outlines the name of the company like Ltd. or Pvt. Ltd., Company.
   ii. *Situation clause*: It gives the details of the registered office i.e. the location of the office.
   iii. *Objects clause:* It furnishes the objective and purposed of establishing the company.
   iv. *Capital clause:* It gives details related to the share capital i.e. equity or preference share capital.
   v. *Liability clause:* The liability of the company is limited liability.
   vi. *Subscription clause:* A declaration duly executed by its subscribers.

   (b) **Articles of association**:

   An article of Association furnishes the byelaws or internal rules that govern the internal conduct of the company. Every organization, big or small, can function only on the basis of some rules, regulations and procedures. All such rules and regulations, necessary for the smooth functioning of a company are included in a document called Articles of association.

   (c) The list of names and address of the proposed directors and their willingness, in writing to act as such, in case of registration of a public company.

   (d) A statutory declaration that all the legal requirements have been fulfilled. It has to be duly signed by any one of the following: a Company secretary, the director, a legal solicitor, a chartered accountant or an advocate of High court.

2. **To obtain certificate of commencement of Business:**

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

The registrar of joint stock companies peruses and verifies whether all these documents are in order or not. If he is satisfied, he will register the documents and issue a certificate of incorporation. In case of private company, it can start its business operations immediately after obtaining certificate of incorporation. If it is a public company needs further details are to be furnished:

a) **Seek permission from Securities Exchange Board of India (SEBI):** The promoters have to make an application furnishing the details of certificate of incorporation, seeking permission to issue prospectus. Prospectus is a notice, letter or circular inviting the public to subscribe the share capital of company.

b) **File Prospectus:** A prospectus means any document described or issued as prospectus and includes any notice, circular advertisement or other document inviting deposits from public or inviting offers from the public for the subscription or purchase of any shares or debentures of a body corporate. Only public companies have the right to issue a prospectus. The contents of a prospectus are:
   i. Name and address of the company.
   ii. Objects of the company.
   iii. Nature of business activity.
   iv. Number and types of shares and debentures issued.
   v. List of promoters with their addresses.
   vi. List of directors with their addresses.
   vii. Rights of different class of shareholders.
   viii. Assets purchased and proposed to be purchased.
   ix. Preliminary expenses incurred.
   x. Name and address of the auditor or auditors.

c) **Collecting Minimum Subscription:** A public company has to get minimum subscription before it can commence its business. According to SEBI guidelines, if the company does not receive 90% of the issue amount from the public subscription within 120 days from the data of issue the amount of subscriptions received should be refunded to the subscribers.

d) **Allotment of Shares:** Shares are allotted as applied for with the consultation of stock exchange on lottery basis.

e) **Apply to registrar for certificate of commencement of business:** The registrar will verify the details and if he is satisfied, he will issue Certificate of Commencement of Business.

KINDS OF COMPANIES

The Joint Stock Companies are divided into 5 different categories on the basis of:

1. Incorporation
2. Liability
3. Controlling Interest
4. Public Interest
5. Nationality

On the basis of Incorporation:

- **Chartered companies:** Incorporated under Royal charter issued by king or Head of State. The East India Company, was incorporated under the same charter.
- **Statutory companies:** The companies are formed according to a special act of parliament or state legislature. Ex: RBI, UTI, IFCI, etc.
- **Registered companies:** Companies formed and registered under the Companies Act 1956 or were registered under any of the earlier Companies Act Example: Public Ltd. Co., Private Ltd. Co.

On the basis of Liability:

- **Companies limited by shares:** The liability of the shareholder is limited to the amount unpaid on the shares held by him.
- **Company limited by guarantee:** The liability of the members is limited to the amount which they undertake to contribute to the assets of the company.
- **Companies with unlimited liability:** These are companies in which the numbers have an unlimited liability. Every member of such a company is liable for the debts of the company, as in an ordinary partnership firm.

On the basis of Controlling Interest:

- **Holding companies:** A holding company is a company, which has control over other company. A company is a holding company if it
    - ✓ controls the composition of the Board of Directors of another company
    - ✓ controls more than half the total voting power of such company
    - ✓ it holds more than half in nominal value of its equity share capital.
- **Subsidiary companies:** A subsidiary company is a company, which is controlled by another company.

On the basis of Ownership/Public Interest:

- **Government Company:** A Government company is a company in which not less than 51 percent of the paid-up share capital is held by the Central government and/or by the State Government or partly by Central Government and partly by one or more State governments.
- **Public company:** A public company is one which is not a private company. The minimum paid up capital is 5 lakh or above. It allows transferring their shares. It can be formed by a minimum of 7 members although there is not maximum limit to its membership. It must have the word "limited" (Ltd.) in its name.
- **Private company:** A private company is one which
    - ✓ restricts the right to transfer its shares, if any;
    - ✓ limits the number of its members to 50, excluding present and past employees;
    - ✓ prohibits any invitation to the public to subscribe any shares or debentures;
    - ✓ prohibits any invitation or acceptance of deposits from persons other than its members.
    - ✓ It should have a minimum paid-up capital of one lakh or higher paid up capital. The name must end with words private limited (Pvt. Ltd.).

On basis of Nationality:

- **Indian Company:** Any company incorporated in India under the Companies Act of 1956, whether functioning in India or outside is called as an Indian Company.
- **Foreign / Multi - National Company:** A foreign company is one which is registered outside India, but operates in India through its branches or agents.

PRIVATE SECTOR AND PUBLIC SECTOR

There are all kinds of business organisations viz., small or large, industrial or trading, privately owned or government owned existing in our country. Since the Indian economy consists of both privately owned and government owned business enterprises, it is known as a mixed economy. The Government of India has opted for a mixed economy where both private and government enterprises are allowed to operate. The economy, therefore, may be classified into two sectors viz., private sector and public sector.

- The **private sector** consists of business owned by individuals or a group of individuals. The various forms of organisation are sole proprietorship, partnership, joint Hindu family, cooperative and company.
- The **public sector** consists of various organisations owned and managed by the government. These organisations may either be partly or wholly owned by the central or state government. They may also be a part of the ministry or come into existence by a Special Act of the Parliament. The government, through these enterprises participates in the economic activities of the country.

FORMS OF ORGANISING PUBLIC SECTOR ENTERPRISES

The government acts through its people, its offices, employees and they take decisions on behalf of the government. For this purpose, public enterprises were formed. A public enterprise may take any particular form of organization depending upon the nature of its operations and their relationship with the government. The forms of organisation which a public enterprise may take are as follows:

- ✓ Departmental undertaking
- ✓ Statutory corporation
- ✓ Government company

DEPARTMENTAL UNDERTAKINGS

This is the oldest and most traditional form of organising public enterprises. These enterprises are established as departments of the ministry and are considered part or an extension of the ministry itself. They act through the officers of the Government and its employees are Government employees. These undertakings may be under the central or the state government and the rules of central/state government are applicable. Examples: railways and post and telegraph department.

Features

1. The funding of these enterprises come directly from the Government Treasury and are an annual appropriation from the budget of the Government.

2. The revenue earned by these is also paid into the Treasury.
3. They are subject to accounting and audit controls applicable to other Government activities.
4. The employees of the enterprise are Government servants and their recruitment and conditions of service are the same as that of other employees directly under the Government.
5. They are headed by IAS officers and civil servants who are transferable from one ministry to another.
6. It is generally considered to be a major subdivision of the Government department and is subject to direct control of the ministry;
7. They are accountable to the ministry since their management is directly under the concerned ministry.

Advantages

1. These undertakings facilitate the Parliament to exercise effective control over their operations;
2. These ensure a high degree of public accountability;
3. The revenue earned by the enterprise goes directly to the treasury and hence is a source of income for the Government;
4. Where national security is concerned, this form is most suitable since it is under the direct control and supervision of the concerned Ministry.

Disadvantages

1. Fail to provide flexibility for smooth operation of business.
2. Delay in making prompt decisions.
3. Unable to take advantage of business opportunities.
4. There is red-tapism in day-to-day operations.
5. There is a lot of political interference through the ministry.
6. Insensitive to consumer needs and do not provide adequate services to them.

STATUTORY CORPORATIONS

Statutory corporations are public enterprises brought into existence by a Special Act of the Parliament. The Act defines its powers and functions, rules and regulations governing its employees and its relationship with government departments. It is financially independent with a clear control over a specified area or a particular type of commercial activity. It is a corporate person and has the capacity of acting in its own name.

Features

1. Set up under an Act of Parliament and are governed by the provisions of the Act.
2. This type of organisation is wholly owned by the state.
3. It can sue and be sued, enter into contract and acquire property in its own name.
4. It obtains funds by borrowings from the government or from the public through revenues, derived from sale of goods and services.
5. The employees of these enterprises are not government or civil servants and are not governed by government rules and regulations.

Advantages

1. They enjoy independence in their functioning and a high degree of operational flexibility.
2. The government generally does not interfere in their financial matters, including their income and receipts.
3. It is a valuable instrument for economic development.
4. It has the power of the government, combined with the initiative of private enterprises.
5. Since they are autonomous organisations they frame their own policies and procedures within the powers assigned to them by the Act.

Disadvantages

1. All actions are subject to many rules and regulations.
2. Government and political interference has always been there in major decisions or where huge funds are involved
3. There is dealing with public, rampant corruption exists.
4. The Government appoints advisors to the Corporation Board.
5. This curb the freedom of the corporation in entering into contracts and other decisions.

GOVERNMENT COMPANY

A government company is established under The Companies Act, 2013 and is registered and governed by the provisions of The Act. According to the section 2(45) of the Companies Act 2013, a government company means any company in which not less than 51 per cent of the paid-up capital is held by:

- the central government, or
- by any state government or
- partly by Central government and partly by one or more State governments and
- includes a company which is a subsidiary of a government company.

These are established for purely business purposes and in true spirit compete with companies in the private sector. A government company may be formed as a private limited company or a public limited company. The government exercises control over the paid up share capital of the company. The shares of the company are purchased in the name of the President of India. Since the government is the major shareholder and exercises control over the management of these companies.

Features

1. It is created under the Companies Act, 2013.
2. The company can file a suit in a court of law against any third party and be sued.
3. The company can enter into a contract and can acquire property in its own name.
4. The employees of the company are appointed according to their own rules and regulations as contained in the Memorandum and Articles of Association of the company.
5. The management is regulated by the provisions of the Companies Act, like any other public limited company.
6. These companies are exempted from the accounting and audit rules and procedures.
7. The government company obtains its funds from government shareholdings and other private shareholders.
8. It is also permitted to raise funds from the capital market.

Advantages

1. A government company can be established by fulfilling the requirements of the Indian Companies Act.
2. It has a separate legal entity, apart from the Government.
3. It enjoys autonomy in all management decisions and takes actions according to business prudence.
4. These companies by providing goods and services at reasonable prices are able to control the market and curb unhealthy business practices.

Disadvantages

1. Since the Government is the only shareholder in some of the companies, the provisions of the Companies Act do not have much relevance.
2. It evades constitutional responsibility, which a company financed by the government should have.
3. The government being the sole shareholder, the management and administration rests in the hands of the government.

IMPORTANT QUESTIONS

1. Define the term business. Discuss the objectives of a business.
2. What are business activities? Explain the characteristics of business activities.
3. Explain the classification of business activities in detail.
4. What are the different forms of business organizations? Discuss the features of a business organization.
5. Define a sole trader form of organization. Explain its features, advantages and disadvantages.
6. What is a partnership firm? Explain its features, advantages and disadvantages.
7. What do you mean by Joint Stock Company? Explain its features, advantages and disadvantages.
8. Define a joint stock company. Analyze the formation procedure of a company.
9. Distinguish between a sole trader and partnership firm.
10. What are public sector enterprises? Explain the forms of public sector enterprises.