What is entrepreneur? What are the functions of entrepreneur?

Chapter 10

ORGANIZATION/Manager/enterpreneur boss

ORGANIZER OR ENTREPRENEUR

Organization is the fourth factor of production.[1] **An organizer is an individual or a body of individuals who brings the other three factors together and makes production possible.** The organizer is also called entrepreneur.[2] It is the entrepreneur who hires other factors, combines them in suitable proportion, supervises the work, purchases raw materials and sells finished goods. He is the owner of productive unit (firm). **Prof. Knight** defines an entrepreneur as **"An entrepreneur is a person who performs the dual functions of risk-taking and control".**

The organizer initially plans the business and starts production of goods in expectation of profit. But it is not necessary that he always gets profit. He may have to bear loss. Thus, we can say that the organizer is risk taker. He introduces new products or new ways of making old products.[3]

Organization and management of a business may be performed by one person as mostly is the case in small business. But the two functions may be separated. If the business is large, the actual management of work may be performed by a paid manager. But an entrepreneur is never a paid manager. He is the owner responsible for profit or loss. Similarly an entrepreneur may or may not invest his own capital in the business. It is possible that he starts business only on borrowed funds. **Prof. Stonier and Hague** state that **"the basic difference between entrepreneur and other three factors is that, land, labour and capital are hireable while organization cannot be hired".**

Important

Role and Functions of the Entrepreneur

The entrepreneur occupies a very important place in production. The specific functions performed by him are as given below.

1. **To prepare Business Plan** The first function of an entrepreneur is to decide the nature of business. He plans *what to produce, how to produce and at what scale.*

2. **Selection of Site** (Place) The entrepreneur selects the site of business. He tries to select the most suitable site to keep the cost of production low e.g. he establishes the business near a road or market or sources of raw material.

3. **Provision** (Arrangement) **of Capital, Land and Labour** Capital is required to establish the business and purchase raw materials etc. If the organizer invests his own capital, the roles of entrepreneur and capitalist combine. If own capital is not enough, the organizer

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[1] The other three factors are: land, labour and capital.

[2] We may say that **'entrepreneurship is economic leadership** and imagination in risk taking, innovating, coordinating and sometimes financing business'. Entrepreneur is a French word that means **"someone who undertakes"**

[3] A **Firm** is an organisation that employs resources for producing and selling goods or services to earn profit.

can borrow. Land may be purchased or hired. Similarly, he hires suitable persons for various kinds of work. He tries to employ most efficient type of workers.

4. Purchase of Raw Materials or inputs The entrepreneur tries to purchase raw-materials at minimum cost. Poor quality, high cost or delay in getting regular supply of raw materials may result in lower profits or even loss.

5. Combination of Factors The entrepreneur adopts that combination of factors which minimizes cost. He may use more capital and less labour or vice versa.

6. Supervision and Management For management of the business, the entrepreneur may himself devote time or hire a suitable manager. Supervision of other people's work is a difficult art. Those who are expert in this art get things done smoothly and efficiently.

7. Sale of Goods and Publicity The entrepreneur not only produces goods but also tries to sell at reasonable prices. To increase sales, he may use publicity and advertisement of his product in newspapers, on radio, TV, internet etc.

8. Risk Taking The entrepreneur is wholly responsible for success or failure of the business. He undertakes risk of loss in the expectation of profit. **The basic difference between labour and entrepreneur is the responsibility of risk taking.**

9. Payments to other Factors of Production Responsibility for paying rewards to hired factors lies on the entrepreneur. He has to pay wages, interest and rent, even if nothing is left for him.

Changes

10. Innovation and Search for Markets Innovation means introduction of new products; improvement in the quality of existing ones; search for more efficient methods of marketing. Entrepreneur always makes efforts to introduce something better than his rivals in the market. Innovation plays an important part in success of modern business.

Important question

TYPES OF ORGANIZATION

Business may take different forms, depending upon the decision about the ownership and control of business.

1. Sole or individual owner (or sole proprietor)
2. Partnership.
3. Co-operative society
4. Company (Joint stock)
5. State enterprise

There are **three basic types** of business firms; sole proprietorship, partnership and company.

INDIVIDUAL OWNER (Sole proprietor)

Sole or individual ownership (or proprietorship) is the oldest, the simplest and the most common form of business organization. In this form, a single person is the organizer of the business. He provides land, labour and capital. If his capital is insufficient, he borrows funds. Similarly, land may be taken on rent. He may perform labour himself or get help of his family members or may hire other workers. He is alone responsible for everything, right from planning of production to the final sale of goods. Any profit or loss will be borne by the individual proprietor.

One-person businesses are common in retailing, farming, construction and in personal services such as hair dressing.

Merits

1. *Easy to Start or Close* An individual owner may or may not consult others to set up a business. He can make the planning of work easily, quickly and start production.

2. *Independence* Sole proprietor is fully independent to take any decision, even to close his business. He can make any transaction and deal. Nobody has the authority to ask for explanation for his work. **Sole owner is his own boss**

3. *Personal Interest* Individual owner takes maximum interest in his business. Because he alone has to bear the loss or reap the profit, he applies all his abilities and efforts to organize the business most efficiently.

4. *Easy Supervision* Such business is easy to supervise. Mostly This type of business is small. The individual can keep an eye at all stages of production. He is aware of the details of business.

5. *Direct Relation with Consumers* He knows the tastes of the buyers and tries to produce goods according to their orders. He provides personal service to the customers.

6. *No Danger of Labour Disputes* The business being small and the decisions being quick, labour disputes seldom take place. Because of direct contact between the owner and workers, there is less chance of misunderstanding. So, productivity of labour remains high.

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7. *Economy in Cost* The owner besides making maximum use of his own labour, can get the help from family members. So, his per unit cost is lower (e.g. less publicity cost).

Demerits

1. *Jack of all Trades*[4] A sole proprietor has to be a jack of all trades. He cannot specialize in particular functions of his business.

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2. *Shortage of Capital* An individual proprietor has less capital, so he can not make use of modern expensive machinery. His per unit cost may be high.

3. *Small Scale of Production* Due to shortage of capital and difficulty in expansion of business, small scale prevents benefits of economies of scale.

4. *Unlimited Responsibility* The individual entrepreneur alone has to bear the responsibility of loss or profit. So he hesitates to take bold and risky decisions.[5]

5. *Lack of Division of Labour and Skill* Because of small business, there is less scope for division of labour. He cannot spend on research and experiments. It is difficult for him to employ most experienced workers and specialists since they demand high salaries.

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[4] 'Jack of all trades but master of none' is a proverb which means that somebody tries to do all jobs but is not expert and master in any one job.

[5] There is **no legal distinction between the individual owner and the business**. Suppose there is some 'Hameed Bakery'. This Hameed Bakery and the person Hameed are the same in the sense that if you have a complaint and dispute that Hameed Bakery has supplied bad eggs, you mean that Hameed has supplied bad eggs. Now consider BATA. If you have a dispute with BATA, it does not mean that you have a personal dispute with Thomas Bata who is president of the company or with any other shareholder or manager.

6. *Difficulty in Credit* The banks and other financial institutions hesitate to lend to individuals or demand high rate of interest. So chances for expansion of business remain limited

7. *Difficulty to Face Crisis* Individual owner has limited capacity to face bad economic conditions in the market. He cannot bear heavy losses or economic crisis for a long period

8. *Wrong Business Decisions* An individual owner depends too much on his own wisdom. But a single person cannot fully know every aspect of business. He may take wrong business decisions.

Important

PARTNERSHIP

When two or more than two persons join to run a business, it is called partnership. In partnership, there is common and shared responsibility about profit or loss. Partnership generally takes place among those persons who are either relatives, friends or known to each other. Partnerships are common in professions such as doctors, architects. It is also available in transport business. Partnerships are created through agreements in which the ownership shares and duties of each partner are specified.

A **partnership** is a business firm jointly owned by two or more people, sharing the profits and jointly responsible for anv losses.

Partnership may take various forms:

1. **Working Partners** The shareholders or partners fully participate in daily functioning of business.

2. **Sleeping partners** A person may invest his capital in some business without directly participating in the working of the business. He is called sleeping partner.

3. **Partners without Capital** A partner may be included in the business because of his special skills about the business. He does not invest capital but provide technical advice only.

Merits

1. It is *easy to set up* a partnership. Only a mutual agreement is required.
2. *Careful decisions* are taken through discussions and consultation. Skill of different people combines.
3. *Division of work* can be easily done because of more than one owner. Partners specialize in different functions e.g. In hotel business, one person may devote himself to production of goods and the other may take up marketing and sitting on sales counter.
4. *More capital* becomes available due to shares of partners. Chances for expansion of business become bright, cost is reduced and profits increase.
5. The business can be organised on *large scale.*
6. *Easy Credit* Compared to individual owner, the partnership has more credit worthiness in the financial market.
7. *Personal interest* Since the responsibility of the partners is unlimited, they take keen interest in the business.

Demerits

Trust

1. *Lack of Mutual confidence* In many cases lack of confidence among partners appears. Misunderstanding develops and business may have to be closed (for trivial reasons)
2. *Personal Dispute* Partners may disagree. Personal disputes may arise which disturb the business. Because partners are not subordinate or employees of each other, it is difficult

to end disputes among equal partners. (It is human psychology that unless someone has more authority than the others, matters do not run smoothing and sooner or later deadlock is created).

3. *Delay in Decisions* Sometimes the partners do not easily agree to each other's proposals, so decisions are delayed and business suffers.

4. *Lack of responsibility* There is a saying, "Everybody's business is nobody's business." Since many partners are jointly responsible, their individual interest decreases

5. *Difficulty to close* If one or more partners are dissatisfied and want to leave, it becomes difficult to close the business or distribute assets.

Unsure

6. *Uncertainty* The future of partnership business is uncertain. Due to misunderstanding or death of a partner, the business ends.

7. *Unlimited responsibility*. In case of loss, responsibility of partners is unlimited i.e. they have to bear the loss in the proportion of their share in the business even if this loss is more than the capital they invested.

Important

COMPANY

JOINT STOCK COMPANY

Company is the most important modern form of business organization, formally called joint stock company. The company is commonly known as 'limited company'. There are many large scale enterprises which cannot be run on the basis of individual proprietorship or partnership. Huge amount of capital is needed which is collected through joint stock company. **When a number of persons, who may be unknown to each other, join together to invest their capital in some common business, it is called joint stock company.**[6]

A joint stock company is formed according to the laws of the country, made for this purpose. A joint stock company can be formed with at least 7 persons. These persons who prepare the plan of the company are called 'promoters'. They submit the plan to the Registrar of Joint Stock Companies along with two documents.

A **company** is an organisation legally allowed to produce and trade.
Shareholders of a company have **limited liability**. The most they can lose is the money spent on buying shares.

(a) **Memorandum of Association** which shows name of the company and directors, purpose of company, amount of capital etc.

(b) **Articles of Association** It consists of by-laws about the shareholders' meetings, election of office bearers (e.g. directors), terms and conditions of employment of workers.

After obtaining a certificate from the government, the company sells its shares in stock exchange market and collects capital. Joint stock companies are of two kinds; public limited and private limited. **Only *public* limited company can sell shares in**

[6] **Joint stock company is a legal entity** (legal person) that carries out business in its own name. Shareholder's liability is limited e.g. Coca Cola; Sony, MCB, Lipton, PSO, Shezan are 'legal persons' in the sense that in all business dealings they are treated like individuals. Thus it is quite meaningful to say that 'Coca Cola has raised the price' or 'Shezan has got a bank loan' just as it is understandable to say that Noor Khan has raised the price of fish or to say that Aftab is earning huge profit.

stock exchange market[7].(Private companies can not do so). There is no limit for the number of shareholders of public limited company. But the number of shareholders of private limited company is restricted to 50.[8]

Shares of a Joint Stock Company

The shares of the company may have a value of 10 rupees, 100 rupees etc. Shares are of various kinds **(a) Preferred shares**, for which some minimum profit is guaranteed. **(b) Ordinary shares which are the most important source of capital** for the company.

Some companies in order to increase their capital resources, issue and sell **debentures** or bonds[9]. The debenture holders are not shareholders. They have given loan to the company and so get fixed interest.

Capital of Joint Stock Company

e.g.
Authorised → 9 million
issued → 7 million

Joint stock companies use different terms about their capital. subscribed → 6 million

1. *Authorised Capital* This is the maximum amount of capital allowed which the company has to collect. Paid up capital → 5 million

2. *Issued Capital* The amount of capital which the company has offered for sale in the share market.

3. *Subscribed Capital* The amount of capital purchased by people in the form of shares is subscribed capital.

4. *Paid up Capital* It is the actual amount paid by the people after purchasing shares. Paid up capital may be less than subscribed capital.

Management **Joint stock company is managed and run by a "Board of Directors".** The directors are elected by shareholders in annual general meeting. The board of directors appoints other office bearers like managers, secretary, engineers etc[10].

Merits

1. *Limited Liability* (responsibility) Because the liability of the owners is limited, a person can invest his capital in the business even if their is risk. [In case of loss the shareholders are not required to pay anything more than the face value of their shares.]

2. *Easy Access to Credit* A joint stock company can get huge amounts of capital from banks and other institutions.[11]

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[7] These companies add the word 'limited' or 'Ltd' at the end of their name e.g. BATA Pakistan Ltd. Or Ahmad Food Products Limited.

[8] Joint stock companies are also called 'corporations' and all joint stock companies in a country together are called **Corporate Sector** of the economy.

[9] In economic theory, the term **'bond'** is used to refer to any piece of paper that provides evidence of a debt carrying a legal obligation to repay the principal amount at some stated future time along with some payment of interest. In ordinary language all debt instruments can be called bonds. **Debenture** is also a debt instrument------ a piece of paper promising repayment of some loan.

[10] **Separation of ownership of business from its control** In joint stock companies the shareholders elect directors, who appoint managers (who receive salary and not profit) . The day to day working of the company is controlled by managers. Although the directors as representatives of shareholders are supposed to supervise the work of managers, yet practically the link between directors and managers is weak. So the managers who are not the owners control the business like owners.

[11] While banks hesitate to advance loans to an individual, say Aslam, they will readily accommodate SUZUKI MOTORS because the latter is a joint stock company. Even the banks may charge a lower rate of interest.

3. *Large Scale Production* Availability of huge amounts of capital makes it possible for the joint stock company to produce goods on large scale and at a lower cost.

4. *Easy to Increase Capital* A joint stock company can increase its capital by selling more shares in the market.[12]

5. *Long Life* A company as a legal entity has a life independent of its individual owners. If one or more shareholders die, or sell the shares, it makes no difference to the company. New shareholders take their place.[13]

6. *Easy to Separate* A shareholder can quite easily separate himself from joint stock company by selling his shares. This is not easy in partnership.

7. *Long-period Projects* Because of its longer life and huge capital, a joint stock company can undertake those projects which will give profit after many years.

8. *Spread of Risk* The risk of the business is spread over a large number of shareholders. A joint stock company can undertake even a risky project which an individual dare not. Investors can also spread risk of their investments by buying shares of a variety of companies.

9. *Increase in national saving and investment* Since a joint stock company provides opportunity to invest savings in shares, national savings are encouraged.

10. *Development of Technology* Due to huge resources and large scale production, joint stock companies[14] make investments in research and new technology.[15]

Check and balance

11. *Audit* Annual audit of company's accounts (statements of income and expenditure) is done by registered audit firms.[16] So chances for misuse of funds decrease.

Demerits

1. *Lack of Interest of Shareholders* Many shareholders become disinterested and leave everything to the directors of the company who usually promote their own interest at the cost of the company.

2. *Initial Difficulties* It is more difficult to establish a joint stock company as compared to individual proprietorship or partnership.

3. *Danger of Monopoly* The companies, due to large size and resources can create monopoly. Sometimes, a few companies make agreement and exploit the consumers.

4. *Labour Disputes* In joint stock company there is no close contact between the workers and actual owners who are shareholders. Paid managers do not give proper attention to the problems of labour. Labourers form trade unions and fight against management.

The company is by far the most effective form of business organisation for raising funds in the share market.
13 There are many companies in the world which have existed over hundred years e.g. **BATA**, Coca Cola
14 Joint stock companies that have spread their activities to more than one country are called **Multinational Enterprises (MNEs)** or according to united nations, **Transnational Corporations (TNCs).** Over the past half century, the number of such corporations has greatly increased . A large portion of world production comes from these corporations. At present more than 25000 TNCs are working. Most of these belong to developed countries. TNCs encourage global competition and transfer of technology among countries. In Pakistan, hundreds of TNCs operate. Some of these are; ICI, BATA, DAEWOO, SONY, HITACHI, SUZUKI, PHILLIPS, GLAXO, PEPSI COLA, NESTLE, SHELL, FUJI FILM, IBM, MICROSOFT, CALTEX, CITI BANK.
15 Thus, these companies have important role in economic development of a country. The prosperity of present day Europe is, along with other factors, due to establishment of joint stock companies.
16 The report is submitted to the government.

5. *Speculation* Over speculation in the stock market about prices of shares may sometimes adversely affect real investment in the country.

6. *Corruption* The directors of big companies usually encourage corruption at higher govt. level to get the country's policies changed to get concessions.

7. *Exploitation of Shareholders* Ordinary shareholders do not have full information about the affairs of company.[17] Directors may misuse company funds.

8. *Disadvantages of Large Scale Production* There are many disadvantages of large scale production. Joint stock companies have to face such disadvantages.

Multinational corporations **(MNC)** or Transnational corporations **(TNC)**

A multinational company or corporation is a firm that operates in more than one country. Its headquarters may be in one particular country. These companies are some of the largest firms in the world, often selling billions of dollars worth of goods and services, employing hundreds of thousand of workers around the globe. Most of these are Public Limited Companies. Examples of such multinationals are: Sony, Coca Cola, Ford, ICI, Samsung, Toyota, Nissan.

MCQs

STATE ENTERPRISES / PUBLIC CORPORATIONS

PUBLIC SECTOR

State enterprises are those industrial and commercial undertakings which are owned and run by government. Some of these consist of public utilities such as postal services and some are just like joint stock companies e.g. WAPDA and PIA. There are some undertakings which are partially owned by the government. **All the activities of the state which are related to production of economic goods are called public sector.**

The **governments are not business organisations.** But when markets fail to perform properly; private monopolies indulge in unfair practices; or there is some socially desirable good or service which a government organisation can provide efficiently and supply at fair prices, it establishes its own enterprises. Public enterprises are one form of govt intervention in the free market functioning. The govt may also take many other measures to control and influence the working of markets.

Up to 19th century, the concept about the activities and functions of the state was that these should be limited. It was thought that the state should not directly take part in economic matters. It should only attend to the security of the country from external aggression and internal peace. During 20th century, when Socialism prevailed in many countries, the public sector expanded everywhere. With beginning of 21st century there appears a consensus that the government should confine itself only regulation of private sector and should not become its rival. Thus all over the world public sector has shrunk. However, the government should not limit itself to public utilities but also undertake other productive activities to support the private sector and to accelerate economic development.

[17] The directors make huge expenditures for their personal use and distribute small profits to shareholders.

In Pakistan, the government has ended its role in many sectors to encourage private sector. Some important institutions remain under government control e.g. Railways, WAPDA, PIA, State Bank, Oil and Gas Corporation, State Trading Corporation.

Merits

1. *Public Welfare* The aim of a government is not to earn profit but to promote social and public welfare. The government may undertake projects which have poor profit prospects but are important for the country's economy e.g. construction of dams.

2. *Development of Heavy Industry* If the private enterprise shows little interest in development of heavy or basic industries, the government should take this responsibility.

3. *Economic and Social Equality* مساوات An important function of the government is to create economic and social equality among the people. Government projects can promote this aim by providing employment and income earning opportunities to people.

4. *Welfare of Workers* State enterprises provide more facilities to their workers. They provide security of job.

5. *Mixed Economy* History shows that compared to pure Socialism or Capitalism, Mixed economy best serves the interest of the people. Thus, state enterprise is needed to balance the evils of private sector.

6. *Controlling prices* Private sector always aims at increasing profits. So, they frequently raise prices. The government by providing some part of the supply of essential commodities can check price rise.

7. *Easy Credit* Compared to private enterprise, state enterprises have easy access to credit. Foreign governments are more inclined to co-operate with state enterprise.

Demerits

1. *Lack of Incentive* incouragement Government employees do not have the incentive to put their best in the business. They become inefficient. So there may be loss or very low profit.[18]

2. *Red Tapism* Files This is one of the important drawback in state owned enterprises. Files are kept pending without decisions. Government officials are not in hurry to settle issues.

3. *Wasteful Expenditure* The government employees are less cost-minded. They make wasteful expenditure and use property carelessly. It raises the cost of production.

4. *Corruption* Corruption, bribery and dishonesty are very common things in state enterprises.

5. *Transfers* Frequent transfers from one post to another of functionaries in state enterprises creates inefficiency and irresponsible attitude.

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[18] Since they are not rewarded properly, the employees of government enterprise lack initiative which is an essential quality for success in business.

6. *Unnecessary Interference* The ministers and top bureaucrats make unnecessary interference in state enterprises. So the people, who are in direct charge of the enterprise, cannot function according to demands of the market.

7. *Political Favouritism* There is nepotism and favouritism in appointments and promotion of relatives or political supporters. Thus, inefficiency takes place. The enterprise is not run on business lines but to patronize political support.

8. *The Government can not function like businessmen* The government is basically a political and administrative institution. It can not be expected to function like businessman or industrialist whose approach is market oriented. The government cannot and should not adopt that approach.

All over the world, the share and importance of public sector has decreased during past three decades. Previously this share had been increasing during first half of 20th century.

COMPARISON OF BUSINESS ORGANIZATIONS

Type of Firm	Capital Structure	Ownership	Control
▪ Sole proprietor	Owner's funds, possibly augmented by loans	By the proprietor	By the proprietor
▪ Partnership	Partner's funds, possibly plus loans as above	By the partners	By the partners (except sleeping partners).
▪ Joint Stock Company	Long term capital obtained from sale of shares and debentures, short term capital from loans.	By shareholders	By shareholders, directors and managers.
▪ Co-operative Society	Members' funds, bonds	By members	By members
▪ State enterprise	Government securities plus govt. loans and grants from general taxation	By the state	By ministers, boards and managers.

EXERCISES

1. Define the terms
   Organisation, Entrepreneur, Innovator, Partnership, Joint stock company, Authorised capital, Limited liability, Bond, Corporate sector, Multinational enterprise, Public sector,
2. Discuss the role of an entrepreneur in a firm
3. Explain the merits and demerits of a joint stock company.
4. State the advantages and disadvantages of state enterprise.
5. Write a note on partnership.