- you want to be a global player by mobilising large resources across the country/world
- you want to bring all like-minded people to share the benefits of the common enterprise (you want to promote a joint stock company) or
- you want to involve government in the IT business (here you want to suggest government to promote a public enterprise!)

To decide this, it is necessary to know how to evaluate each of these alternatives. This chapter helps you to take a right decision. This chapter deals with the features, advantages and disadvantages of different forms of business organisation based on ownership and suggests where each form fits in.

FACTORS AFFECTING THE CHOICE OF FORM OF BUSINESS ORGANISATION

Before we choose a particular form of business organisation, let us study what factors affect such a choice? The following are the factors affecting the choice of a business organisation:

1. **Easy to start and easy to close** The form of business organisation should be such that it should be easy to start and 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. The idea is to pool the expertise of all the people in business and run the business most efficiently.
3. **Large amount of resources** Large volume of business requires large volume of resources. Some forms of business organisations do not permit to raise larger resources. Select the one which permits to mobilise 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 organisation you select should be such that it should permit to take care of the business secrets. We know that century old business units are still surviving only because they could successfully guard their business secrets.
6. **Transfer of ownership** There should be simple procedures to transfer the ownership to the next legal heir.
7. **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. Where ownership, management and control are widely distributed, it calls for a high degree of professional skills to monitor the performance of the business.
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 organisation which permits you to take decisions quickly and promptly. Delay in decisions may invalidate the relevance of the decisions.
10. **Personal contact with customers** 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 More profit means more tax. Choose such a form which permits to pay low tax.

These are the parameters against which we can evaluate each of the available forms of business organisations.

FORMS OF BUSINESS ORGANISATION

The following are the forms of business organisation* based on ownership:

(a) Sole trader or proprietorship
(b) Partnership
(c) Joint stock company
(d) Cooperative society

Where the government takes part in business, public enterprise is set up.

Now let us see the features, advantages and disadvantages of each of the form of business organisations. We will also see under what conditions, each form fits in suitably.

SOLE TRADER

The sole trader is the simplest, oldest and natural form of business organisation. 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 organisation wherein the trader assumes all the risk of ownership carrying out the business with his own capital, skill and intelligence. He is the boss for himself. He has total operational freedom. He is the owner, manager and controller. He has total freedom and flexibility. Full control lies with him. 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. He is responsible for himself. This form of organisation is popular all over the world. Restaurants, supermarkets, pan shops, medical shops, hosiery shops, the list of such small establishments are endless. The features of this form of organisation can be described as follows:

Features

- It is easy to start a business under this form and also easy to close.
- He introduces his own capital. Sometimes, he may borrow, if necessary.
- He enjoys all the profits and in case of loss, he alone suffers.
- He has unlimited liability which implies that his liability extends to his personal properties in case of loss.
- He has a high degree of flexibility to shift from one business to the other.
- There are very little legal hassles to be observed by a sole trader. Except in such businesses where license is required for instance, hotels and so on, the sole trader is free to take up any business.

* Joint Hindu family is another form of business organisation where the business is taken care of by the male members of joint family. This form is losing ground because of socio-economic response.

- As he is alone, he has to look after by him/herself all the activities related to purchase, sale, cash, accounts and taking care of the customers. He may take the help of his family members or paid employees in carrying out the business.
- Business secrets can be guarded well.
- 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.
- He has total operational freedom. He is the owner, manager and controller.
- He can be directly in touch with the customers.
- He can take decisions very fast and implement them promptly.
- Rates of tax, for example, income tax and so on are comparatively very low.

Advantages

The following are the advantages of the sole trader form of business organisation:

1. *Easy to start and easy to close* Formation of a sole trader form of organisation is relatively easy. Even closing the business is easy.
2. *Personal contact with customers directly* 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 can be made promptly.
4. *High degree of flexibility* Based on the profitability, the trader can decide to continue or change the business, if need be.
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. *Direct motivation* If there are profits, all the profits belong to the trader himself. In other words, if he works more hard, 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.
8. *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.
9. *Minimum 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 prices for his products/services if he enjoys monopoly market.
10. *Transferability* The legal heirs of the sole trader may take the possession of the business.

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 mobilise 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. Family members and relatives cannot show as much interest as the trader takes.
4. *Uncertainty* There is no continuity in the duration of the business. On the death, insanity or insolvency the business may come to an end.
5. *Inadequate for growth and expansion* This form is suitable for only small size, one-man-show type of organisations. This may not really work out for growing and expanding organisations.
6. *Lack of specialisation* The services of specialists such as accountants, market researchers, consultants and so on, are not within the reach of most of the sole traders.
7. *More competition* Because it is easy to set up a small business, there is a high degree of competition among the small business men and a few who are good in taking care of customer requirements alone can survive.
8. *Low bargaining power* The sole trader is 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.

Suitability

Despite the above disadvantages, the sole trader is a suitable form of organisation where

- business is of small size and requires low volume of capital
- business can be managed by one person
- risk is low
- personal attention is necessary to take care of the customers
- products/services need to be provided as per the customer specifications

PARTNERSHIP

Partnership is an improved form 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.*

From this definition, the features of partnership can be described to be as follows:

Features

1. *Relationship* Partnership is a relationship among persons. It is a 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. Every partner is both an agent and a principal. Agent for other partners and principal for himself. All the partners are agents and the 'partnership' is their principal.

The following are the other features:

(a) *Unlimited liability* The liability of the partners is unlimited. The partnership and partners, in the eye of law, are 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.

(b) *Number of partners* According to the Indian Partnership Act, the minimum number of partners should be two and the maximum number is restricted, as given below:

- 10 partners in case of banking business
- 20 in case of non-banking business.

(c) *Division of labour* Because there are more than two persons, the work can be divided among the partners based on their aptitude.

(d) *Personal contact with customers* The partners can continuously be in touch with the customers to monitor their requirements.

(e) *Flexibility* All the partners are likeminded persons and hence they can take any decision relating to business.

(f) *Joint and several liability* This is a special feature of partnership. The purpose of this feature is to check the behaviour of the partners so that they do not act at the cost of the other partners. All the partners are jointly and severally liable for the debts of the partnership. No one partner can say that he is not liable for the debts of the firm and others alone are responsible. If one partner is responsible for a debt, other partners are also equally responsible for this debt. Similarly, if the creditors absolve one partner from a debt, other partners are automatically freed or absolved from that liability.

(g) *Implied authority* The partner looking after the affairs of the partnership has certain implied authority. For instance, such a partner is empowered to take decisions of not more than a value of, say, Rs 5,000. Where the decisions of higher value have to be taken, he has to consult others. Each partner binds others through his acts since every partner is the agent of the firm. In other words, the act of every partner is deemed to be an act of the firm and binding on the firm.

(h) *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.

(i) *Taxation* In the partnership form of organisation, profits of partnership and individual incomes of partners are taxed separately. The share of profits from the partnership is included in the individual partners' incomes only to find out the tax rate applicable. However, there is relief in the tax on the share from profits from the firm (to avoid double taxation).

(j) *Dissolution* The closure of partnership is called 'dissolution'. When any of the partners die, becomes insolvent or insane, the partnership is to be dissolved. This means that the duration of the partnership is not certain. The remaining partners can, if they are interested, restart their business with a new name.

Partnership Deed

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

1. Names and addresses of the firm and partners
2. Nature of the business proposed
3. Duration
4. Amount of capital of the partnership and the ratio for 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, if any, 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 or 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, if any, can be referred to for settlement.
12. Special rights, obligations and liabilities of partner(s), if any.

Kinds of Partners

The following are the different kinds of partners:

1. Active Partner Active partner takes active part in the affairs of the partnership. He is also called working partner.

2. Sleeping Partner Sleeping partner contributes to capital but does not take part in the affairs of the partnership.

3. Nominal Partner Nominal partner is partner just for namesake. He neither contributes to capital nor takes part in the affairs of business. Normally, the nominal partners are those who have good business connections, and are well placed in the society. The partnership derives benefit from such contacts in terms of business growth and increase in profits.

4. Partner by Estoppel Estoppel means behaviour or conduct. Partner by estoppel gives an impression to outsiders that he is the partner in the firm. In fact he neither contributes to capital, nor takes any role in the affairs of the partnership. Because he has misled the outsiders, partner by estoppel is held liable for the claims, if any, of the outsiders.

5. Partner by Holding out If partners declare a particular person (having social status) as partner and this person does not contradict even after he comes to know such declaration, he is called a partner by holding out and he is liable for the claims of third parties. However, the third parties should prove they entered into contract with the firm in the belief that he is the partner of the firm. Such a person is called *partner by holding out*.

6. Minor Partner Minor has a special status in the partnership. A minor can be admitted for the benefits of the firm. A minor is entitled to his share of profits of the firm. The liability of a minor partner is *limited* to the extent of his contribution of the capital of the firm.

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. Every partner is both an agent and a principal. Agent for other partners and principal for himself. All the partners are agents and the 'partnership' is their principal.

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After attaining majority, the minor is free to continue as partner or severe his relations with the firm. In case he chooses to severe, he has to give a public notice of such a decision within six months from the date of attaining majority. If he does not give such a notice, it means that he opts to continue as partner, he becomes a full-fledged partner with unlimited liability.

Registration of Partnership

Registration of partnership is not compulsory. It is voluntary. An unregistered firm or its partners cannot file a suit against the third party in support of its claim. Hence it is desirable to get the firm registered with the Registrar of Partnerships under Indian Partnership Act, 1932 by furnishing the details (such as name of the firm, details of the main office and its location, address, its branch offices, date of admission of partners into the firm and the addresses of the partners) in the prescribed form along with the necessary fee for registration.

The main advantage of a registered firm is that it creates confidence in the eyes of the public.

Rights, Obligations and Liabilities of Partners

Normally, the partnership deed specifies the rights, obligations and liabilities of the partners. Where the partnership deed is silent about these, the following rights, obligations and liabilities of partners, as stated in Indian Partnership Act, 1932 will be applicable.

Rights of Partners

Every partner has a right

(a) To take part in the management of business
(b) To express his opinion
(c) Of access to and inspect and copy any book of accounts of the firm
(d) To share equally the profits of the firm in the absence of any specific agreement to the contrary
(e) To receive interest on capital at an agreed rate of interest from the profits of the firm
(f) To receive interest on loans, if any, extended to the firm.
(g) To be indemnified for any loss incurred by him in the conduct of the business
(h) To receive any money spent by him in the ordinary and proper conduct of the business of the firm.

Obligations and Liabilities of Partners

The following are the obligations and liabilities of the partners to the firm and towards each other:

(a) Carry on the business to the maximum advantage of the firm and all the partners
(b) Be just and faithful to one another and to the firm
(c) Give full and correct information and true accounts of the firm to one another
(d) Indemnify the firm or any partner against any loss, if any
(e) Share the losses equally, unless differently agreed to
(f) Not to engage in any activity which competes with the firm's business
(g) Not to make any benefit or income while dealing with the firm
(h) Not to assign or transfer his interest in the firm to any other person without the consent of all the other partners.

Obligations and Liabilities to Third Parties

The partners have obligations and liabilities to third parties also. These obligations result from the agency relationship between the partners and the firm when they deal with the outsiders.

- The partners are jointly and severally liable for the claims of the third parties. The partners have unlimited liability in this regard.
- They are liable for any type of loss caused to the third parties by a wrongful act of any partner in the normal course of business.

Implied Authority of Partner as an Agent of the Firm

The partner as an agent of the firm has certain implied authority

- To buy, sell and pledge the goods
- To raise loan on the security of such goods
- To collect the debts of the firm as against valid receipts
- To accept make or issue bills of exchange, promissory note and such like on behalf of the firm.

This implied authority, however, does not (unless authorised by Partnership Deed) empower any partner to

- Submit any dispute concerning the firm to arbitration
- Open firm's bank account in his own name
- Compromise or give up any claim of the firm
- Withdraw any suit filed on behalf of the firm
- Acquire or transfer immovable property for the firm
- Admit any liability in a suit against the firm
- Enter into partnership with others on behalf of the firm.

Advantages

The following are the advantages of the partnership form:

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 facilitates 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 decisions and prompt actions* If there is consensus among partners, it is enough to implement any decision and initiate prompt actions. Sometimes, it may take more time for the partners on strategic issues to reach consensus.

7. *The positive impact of unlimited liability* Every partner is always alert about his impending danger of unlimited liability. Hence he tries to do his best to bring profits for the partnership firm by making good use of all his contacts.
8. *Tax rate* When compared to company form, the tax rate is low.

Disadvantages

The following are the disadvantages of partnership:

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 results 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. *Limited growth* The resources when compared to sole trader, a partnership may raise little more. But when compared to the other forms such as a company, resources raised in this form of organisation are limited. Added to this, there is a restriction on the maximum number of partners.
5. *Instability* The partnership form is known for its instability. The firm may be dissolved on death, insolvency or insanity of any of the partners.
6. *Lack of Public confidence* Public and even the financial institutions look at the unregistered firms with a suspicious eye. Though registration of the firm under the Indian Partnership Act is a solution for such problem, this cannot revive public confidence into this form of organisation overnight. The partnership can create confidence in others only with their performance
7. *Implied authority misused* Where there is no periodic monitoring, there is a possibility that the active partner may misuse his implied authority. One of the solutions for this problem is that the partners should meet once every month and review the progress from time-to-time.
8. *High tax rate* When compared to the sole trader the tax rate is higher.

Suitability

Despite the disadvantages, the partnership form of business organisation is popular where the business

- requires moderate volume of funds, as much as partners can bring
- requires more persons of different skills which can be used for the common advantage of all partners.

Today, there are a number of partnership firms successfully carrying on their business for over decades. The secret of their success is the cohesive group of partners. Without such a group, partnership cannot survive for long.

JOINT STOCK COMPANY

The joint stock company emerges form 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. Against this background, it is interesting to study the functioning of a joint stock company. The main principle of the joint stock company form is to provide opportunity to take part in business with as low investments as possible say Rs 1000. Joint Stock Company has been a boon for investors with moderate funds to invest.

The system of Joint Stock Company has been very useful for large undertakings which require huge capital. Here the capital is divided into certain units. Each unit is called a share. The price of each share is kept so low that even a common man can find it comfortable to pick it up!

The company has been centuries old concept and one of the few companies is the history of the East India Company, the chartered company which came into existence by a Royal Charter. Such companies that have been in existence before the enactment of Indian Companies Act, 1956 are called old companies.

The radical changes in the field of production, and distribution of goods, particularly after the industrial revolution, necessitated large amounts of capital investment and needed better managerial skills. A company type of organisation filled this gap perfectly. The joint stock companies have been a powerful and efficient engine of production; effective medium for the supply of larger amounts of capital to the trade and industry.

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

Company Defined

Lord Justice Lindley explained the concept of the joint stock company form of organisation as "an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. The common stock refers to the share capital of the company. The persons who contributed it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable, although the right to transfer is often more or less restricted."

Section 3 (1) of the Companies Act, 1956 defines[a] a company as a company formed and registered under the Act or an existing company.

Section 566 (1) and (2) of the Indian Companies Act, 1956 defines[b] Joint Stock Company as "a company having a permanent paid-up or norminal share capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock or divided and held partly in the one way and partly in the other, and formed on the principles of having for its members the holders of those shares or that stock and no other persons. Such a company, when registered with limited liability under this Act, shall be deemed to be a company limited by shares".

A joint stock company is described as a voluntary association of persons recognised by law, having a distinct name, a common seal, formed to carry on business for profit, with capital divisible into transferable shares, limited liability, corporate body and perpetual succession.

In brief, it is like an artificial person created by law with perpetual succession and common seal.

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[a] Compaines Act as amended by Companies (Amendment) Act, 2000

[b] Ibid.

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 independent existence. It is separate from its members. It can acquire the assets. It can borrow for the company. It can sue others if they are in default in payment of dues, breach of contract with it, if any. Similarly, it can be sued by outsiders for any claim. A shareholder is not liable for the acts of the company. Similarly, the shareholders cannot bind the company by their acts.
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. *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.
5. *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 (i.e., known for their reputation in terms of reliability character and dynanism) are likely to attract huge resources.
6. *Transferability of shares* In the company form of organisation, the shares can be transferred from one person to the other. A shareholder of a public company can sell his holding of shares at his will. However, the shares of a private company cannot be transferred. A private company restricts the transferability of the shares.
7. *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. Every document or contract should be affixed by the common seal, otherwise the company is not bound by such a document or contract.
8. *Perpetual succession* 'Members may come and members may go, but the company continues for ever and ever'. A company has uninterrupted existence because of the right given to the shareholders to transfer the shares.
9. *Ownership and Management separated* The shareholders are spread over the length and breadth of 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. Thus the management is separated from the owners.
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 or 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.

Kinds of Companies

Kinds of companies based on incorporation

1. **Chartered company:** A chartered company is created by the Royal Charter of the State. The Charter contains the rights, privileges, and powers to be used by the chartered company, for example, British East India Company formed in England in 1600 to trade with India and the East.
2. **Statutory corporation:** A statutory corporation is created by an Act of the state legislature or Parliament. The objective, scope, powers, responsibilities are clearly defined in this Act. The examples of statutory corporation are Reserve Bank of India, Industrial Development Bank of India, Food Corporation of India, APSRTC.
3. **Registered company:** A registered company is one that is registered under Indian Companies Act, 1956 (earlier, it was Indian Companies Act, 1913). The provisions of the Act govern the formation and working of these companies. A registered company may be a public limited company, private limited company, government company, company limited by guarantee or an unlimited company.

Kinds of companies based on public interest

The following are kinds companies based on public interest.

1. **Private limited company:** According to Sec. 3 of Indian Companies Act[8], a private company means a company that has a minimum paid up capital of one lakh rupees or such higher paid up capital as may be prescribed, and by its articles
   (a) restricts the right of transfer its shares, if any
   (b) limits the number of its members to fifty excluding present and past employees
   (c) prohibits any invitation to the public to subscribe any shares in or debentures of, the company
   (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives

   The name of a private company should necessarily end with the words' private limited' (Pvt. Ltd.).
2. **Public company:** This means a company that
   (a) is not a private company
   (b) has a minimum paid up capital of five lakh rupees or such higher paid up capital, as may be prescribed
   (c) is a private company, which is a subsidiary of a company that is not a private company.
   (d) allows transfer of its shares
   (e) can have any number of members but minimum, there should be seven members
   (f) can issue the prospectus to raise the capital

The name of the public company ends with the word 'limited' (Ltd.)

...ment) Act 2000

Public company and private company compared

Points of difference	Public company	Private company
1. Minimum and maximum number of members	Minimum 7; maximum unlimited	Minimum 2; maximum 50
2. Transfer of shares	No restrictions on transfer of shares	Restricted
3. Issue of prospectus	Prospectus can be issued	Prohibited from issue of prospectus
4. Acceptance of deposits	Can accept	Prohibited from accepting deposits from public. However, it can accept deposits from its members, directors or their relatives.
5. Minimum paid up capital	Rs. 5 lakh or higher, as may be prescribed	Rs. 1 lakh or higher as may be prescribed.

3. **Government company:** Section 617 of Indian Companies Act, 1956 defines a government company as "any company in which not less that 51 percent of the paid-up share capital is held by Central government, or by any state government or governments, or partly by Central government and partly by one or more stage governments and includes a company which is a subsidiary of government company." Example are National Thermal Power Corporation (NTPC), Bharat Heavy Electricals Ltd. (BHEL), Hindustan Machine Tools (HMT), Hindustan Port Trust, Steel Authority of India (SAIL).

On the basis of controlling interest

Holding and subsidiary companies: A holding company is a company that controls the composition of the board of directors of another company or holds more than half of the nominal value of the equity share capital of another company. The other company that is controlled by the holding company is called subsidiary company. A company (say, X), which is a holding company of another company (say Y), but subsidiary of a third company (say, Z), then that another company (Y) will also be subsidiary of the third company (Z).

Kinds of companies based on liability

Based on liability, the companies can be divided into three types:

(a) **Unlimited company:** An unlimited company is a company in which the liability of every member is unlimited. This implies that the personal property of every member is also liable for the debts of the company. The liability of a member is enforceable only at the time of winding up of the company. Unlimited companies are rarely found in practice even though as per Indian Companies Act, unlimited companies can be incorporated.

(b) **Limited company:** A company is said to be limited liability company where the liability of its members is limited by the unpaid amount on the shares respectively held by them. Generally, the companies incorporated under Indian Companies Act are limited liability companies only.

(c) **Companies limited by guarantee:** A company is said to be limited by guarantee where the liability of the members is limited to such an amount as they agreed upon to contribute to the assets of the company in the event of being wound up.

Kinds of companies based on nationality

Based on nationality the companies can be divided into two types:

(a) **Foreign company:** Foreign company is a company incorporated outside India but established a place of business within India. Foreign companies come under the purview of the Indian Companies Act, 1956.

(b) **Indian company:** A company incorporated in India under the Indian Companies Act, 1956.

Formation of a Joint Stock Company

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

(a) to obtain Certificate of Incorporation
(b) to obtain Certificate of Commencement of Business.

The Certificate of Incorporation is just like a 'date of birth' certificate. It certifies that a company with such and such a name is born on a particular day. Certificate of Commencement of Business authorises a public company to start its commercial operations officially. A public company has to comply with certain requirements 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 persons who conceive the idea of starting a company and who organise the necessary initial resources are called *promoters*. The vision of the promoters forms the backbone for the company in the future to reckon with.

The promoters have to file the following documents, along with necessary fee, with the 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. It furnishes all its details in six clauses such as (ii) Name clause (ii) Situation clause (iii) Objects clause (iv) Capital clause (v) Liability clause and (vi) Subscription clause duly executed by its subscribers.

(b) Articles of Association Articles of Association furnishes the bye-laws or internal rules governing the internal conduct of the company.

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

(d) A statutory declaration that all the legal requirements have been fulfilled. The declaration has to be duly signed by any one of the following: company secretary in whole time practice, the proposed director, legal solicitor, chartered accountant in whole time practice or advocate of High Court.

The Registrar of Joint Stock Companies peruses and verifies whether all these documents are in order or not. If he is satisfied with the information furnished, he will register the documents and then issue a Certificate of Incorporation. If it is private company, it can start its business operations immediately after obtaining Certificate of Incorporation. If it is a public company, the following formalities are to be completed further:

1. Seek Permission from the Securities Exchange Board of India (SEBI)

The promoters have to make an application furnishing the details of Certificate of Incorporation to Securities Exchange Board of India, seeking permission to issue Prospectus. Prospectus is a notice, letter or circular inviting the general public to subscribe to the share capital of the company.

2. File Prospectus with Registrar After seeking permission from SEBI, file the Prospectus with the Registrar of Joint Stock Companies. If the company does not issue prospectus, it has to file 'Statement in lieu of Prospectus' together with declaration in form 20 duly executed by one of its director with the Registrar before raising capital and allotting the shares to its members. The registrar after verifying the documents and if found in order, register the documents, or issue a certificate of commencement of business.

3. Collecting Minimum Subscription Minimum subscription refers to the minimum amount of capital required to start the business operations such as acquiring fixed assets, working capital, payment of share issue expenses such as brokerage, underwriting commission, and so on. SEBI decides the amount of minimum subscription necessary from case to case. The company has to furnish the details of minimum subscription in the prospectus.

It is necessary that the amount of minimum subscription is raised within 70 days from the date of issue of prospectus. If the company fails to raise the minimum subscription within the said time limit, the company is bound to refund entire share application many forthwith.

4. Allotting Shares Normally shares are allotted as applied for. In case of oversubscription, the basis of allotment is finalised in consultation with the stock exchange under which it is proposed to be listed and the allotment is made on lottery basis. In case of unsuccessful applicants, the money received with the share application will be refunded within a specified time, failing which the company is bound to pay with interest and also liable for legal action.

5. Apply to the Registrar for the Certificate of Commencement of Business
After raising minimum subscription, the company has to make an application again with the following declarations that:

(a) minimum subscription as stated in the Prospectus has been collected
(b) directors have paid, as much as called up, on the shares held by them
(c) all the legal formalities have been fulfilled and to this effect, it should be duly signed by anyone of the directors, legal solicitor or chartered accountant.

The Registrar will once again verify the exactness of the details of the above declarations. If he is satisfied, he will then issue Certificate of Commencement of Business.

A public company can start its operations immediately from the date of obtaining the Certificate of Commencement of Business.

Main Documents in Company Formation

The main documents in company formation are

(a) Memorandum of Association
(b) Articles of Association
(c) Prospectus

While drafting the contents of these documents, the promoters should take a special care to fit their vision into the contents of these documents. Otherwise, it will be difficult to change its contents at a later date. The procedure laid under Companies Act to amend the contents of these main documents is very tedious and cumbersome.

The detailed contents of these documents are furnished below.

1. Memorandum of Association Memorandum of association is also called the charter or constitution for the company. It is because, it lays down in precise and clear terms the objectives of the company, defines the scope of its operations and its relations with the investors and outside world. The company has to necessarily conduct its operations within the limits set by the Memorandum of Association. It is a public document and hence it should be printed and made available to the public for a price. The contents of Memorandum of Association are classified into six clauses. They are:

(a) *Name clause* This clause deals with the name particulars of the company. It is necessary that the name of a private company should end with the words 'private limited' and that of a public company should end with 'limited'.

(b) *Registered or situation clause* This clause deals with the particulars of state in which registered office is proposed to be situated.

(c) *Objects clause* The objectives of the company, in the short run and long run, are furnished here. The promoters should take special care to draft the objects clause in particular. The objects should be drafted in such a way that they provide high degree of operational freedom.

(d) *Liability clause* This clause specifies that the liability in respect of the shares issued by the company is limited by the face value of the shares.

(e) *Capital clause* It specifies the details of authorised capital with which it plans to get registered. This clause explains the particulars of the amounts of equity and preference share of capital to be issued by the company.

(f) *Subscription clause* Here a declaration has to be made that 'the persons signing this clause have interest to form this company and they have taken the number of shares as indicated against their names. The declaration is to be signed by two members in case of a private company and seven members in case of a public company, and duly witnessed.

2. Articles of Association Articles of the association contains the rules of procedure for the internal management and control of the affairs of the company. It is concerned with the procedural matters in conducting the routine matters of the company. It supplements the Memorandum of Association and hence it cannot include that which is prohibited by the Memorandum. The Memorandum defines the relationship of the company with the outside world, while the Articles of Association refers to rules of procedure in the internal management and control of the affairs of the company.

In the case of a private company, the articles should necessarily restrict the company from the issue of prospectus, the maximum number to 50 and the transferability of shares. It prohibits any invitation or acceptance of deposits from persons other than its member, directors or their relatives. The main contents of Articles of Association are as follows:

(a) Amount of share capital and different types of capital

(b) Methods to increase, reduce or alter capital

(c) Different types of shares, their respective rights, Lien and calls on shares, forfeiture, conversion of shares

(d) Procedure in respect of transfer and transmission of shares

(e) Procedure to conduct board meetings and general body meetings
(f) Powers, rights and duties of directors in the Board
(g) Procedure in appointment and removal of a director
(h) Remuneration of directors
(i) Matters relating to accounts and audit
(j) Procedure for amending the contents of memorandum of association
(k) Procedure for Distribution of dividend, creation of reserves, de
(l) How to maintain the statutory books and records
(m) Procedure for winding up
(n) Rules regarding common seal of the company

Where a public company does not issue its own Articles of Association, it is deemed to have adopted the articles laid down in Table A of the Companies Act. Table A contains a set of model rules designed for the conduct of the affairs of a company.

3. Prospectus A prospectus is defined as a 'notice, circular, advertisement or any other document inviting offers from the public for the subscription or purchase of any shares in or debentures of the body corporate'.

Prospectus is the first and basic document that supports the structure of the company. An investor will go through prospectus to assess the feasibility of his investment in the company. It is necessary that the company discloses full information relating to the amount issued, the rights attached to each type of shares issued, the property purchased or proposed to be purchased by the company, directors, auditors, bankers, agents, underwriters to the issue and so on. It also should mention the risks, if any, the company faces. The prospectus should be drafted interms of Sec 56 read with Schedule II of the Companies Act, 1956 strictly.

At times, public company may decide not to go to public for raising capital. If it chooses to avoid issue of prospectus, it has to file a *Statement in lieu of Prospectus* (as stated in Schedule III of the Companies Act) with the Registrar. The Statement in lieu of Prospectus should be duly signed by all the directors and submitted to the Registrar on or before three days from the date of allotment of the shares.

Contents of Prospectus

The following are the contents of the Prospectus:

(a) the name of the company and address of its registered office
(b) the nature and business of the company
(c) the main objectives of the company
(d) the number and types of shares and debentures issued in the past
(e) the list of promoters with their names, addresses and their past record
(f) the list of directors with their names, addresses and occupations
(g) the list of signatories to the Memorandum of Association and their names, addresses
(h) details of the brokers, underwriters, merchant bankers, bankers to the public
(i) rights and restrictions as applicable to each class of share or debenture
(j) amount of minimum subscription to be received before the allotment of shares

(k) opening date and closing date of public offer
(l) minimum number of shares to be applied and how much is to be paid per share on application
(m) preliminary expenses incurred
(n) property purchase or proposed to be purchased
(o) amount of reserve fund and how it is to be utilised
(p) the names of auditors, bankers and solicitors

Prospectus is a sensitive document of the company. It is so because for any mistake in the prospectus, the promoters and directors responsible for issue of prospectus will personally be liable, for any misstatement in prospectus, civil and criminal proceedings can be initiated against them as per the provisions of the Companies Act. Most of the companies, for this reason, restrict their liability by announcing the prospectus given in the newspapers as a 'Statement but not a Prospectus'. For the exact information, the public is directed to see the official document issued by the company.

Advantages

The following are the advantages of a Joint Stock Company:

1. *Mobilisation of larger resources* A joint stock company provides opportunity for the investors to invest, even small sums, in the capital of large companies. This facilitates raising 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. *Inculcates the habit of savings and investments* Because the share face value is very low, this promotes the habit of savings among the common man and mobilises the same towards investments in the company.
7. *Democracy in management* The directors are elected by the shareholders in a democratic way in the general body meetings. The shareholders are free to make any proposals, question the practices of the management, suggest the possible remedial measures as they perceive. The directors respond to the issues raised by the shareholders and have to justify their actions.
8. *Economies of large scale production* Since the production is in the large scale with large funds at its disposal, the company can enjoy the internal economies of large scale production.
9. *Continued existence* The company has perpetual succession. It has no natural end. It continues forever and ever unless law puts an end to it.
10. *Institutional confidence* Financial Institutions prefer to deal with companies in view of their professionalism and financial strengths.
11. *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.

12. *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.

All that shines is not gold. The company form of organisation is not without any disadvantages. The following are the disadvantages of joint stock companies.

Disadvantages

1. *Formation of company is a long drawn 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 organisation grows, the number of levels in the organisation also increases in the name of specialisation. The more the number of levels, the more is the delay in decision making. Sometimes, so called professionals do not respond to the urgencies as required. It promotes delay in administration which is referred to 'red tape and bureaucracy'. With all these, the company form of organisation tends to be an inflexible organisation.
4. *Oligarchy in management* Though it looks like the affairs are conducted in a democratic way, a detailed insight into the functioning of the general body meetings reveal that very few shareholders who hold majority of shareholding try to dominate the scene. With the result, the control is in the hands of a very few shareholders who have vested interests. The voting powers are in proportion to the number of shares one holds. If the shares held are more in number, the voting rights are also more. Those who have large number of shares always dominate.

   Further, it shows that the majority of the shareholders who do not have significant shareholding have no effective voice in the management of the affairs of the company. Often the reports presented in the meetings are window dressed and they mislead the shareholders. The cases where some of the shareholders create groups of common interest and consolidate their hold on the company by manipulation of voting power. Finally, it looks as though the shareholders at large tend to be mere pawns in the hands of the board of directors.
5. *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.
6. *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. Where managers do not show up willingness to take responsibility, they cannot be considered as committed. They will not be able to handle the business risks.
7. *Conflicting interests* The company has divergent groups of people associated with it. The shareholders want maximum dividends. The company wants to maintain good amount of reserves. It is not possible to pay larger dividends, and yet, to maintain good amount of reserves. It is necessary to reconcile such conflicting interests. The board of directors usually justify their actions of declaring low or high rate of dividend.

8. *Promotes speculation* Speculation is the process of expecting a higher price for a particular share and buying it at a lower rate. In the stock markets where shares are bought and sold, speculation is the undercurrent of all transactions. In this process, there is danger that some shares are manipulated and common investors are trapped in such manipulation. At times, prices are manipulated. The common investors buy certain shares with the expectation that the prices of these shares will go up further. They seldom realise that they are manipulated prices.
9. *Lobbying with government departments* The corporate giants have the capacity to lobby with the government departments to influence the government policies to suit their business conditions. The corporate giants gain this strength only from their large base of funds.
10. *Tends to monopoly* Where the company has grown to larger size, it may fix the price on its own for its products and services as a monopolist.
11. *Higher taxes* The rate of income tax is very high when compared to the other forms of organisation.

Suitability

The joint stock company has become indispensable for every business activity, particularly if it is to be carried out on a large scale. It is more suitable where

- there is a need for a high degree of specialisation
- there is need for large funds
- there is a need for growth and expansion
- there is need for government control or interference

PUBLIC ENTERPRISES

Public enterprises occupy an important position in the Indian economy. Today, public enterprises provide the substance and heart of the economy. Its investment of over Rs 10,000 crore is in heavy and basic industry, and infrastructure like power, transport and communications. The concept of public enterprise in India dates back to the era of pre-independence.

Genesis of Public Enterprises

In consequence to declaration of its goal as socialistic pattern of society in 1954, the Government of India realised that it is through progressive extension of public enterprises only, the following aims of our five year plans can be fulfilled.

- higher production
- greater employment
- economic equality, and
- dispersal of economic power

The government found it necessary to revise its Industrial Policy in 1956 to give it a socialistic bent.

Need for Public Enterprise

The Industrial Policy Resolution 1956 states the need for promoting public enterprises as follows:

- to accelerate the rate of economic growth by planned development
- to speed up industrialisation, particularly development of heavy industries and to expand public sector and to build up a large and growing cooperative sector
- to increase infrastructural facilities
- to disperse the industries over different geographical areas for balanced regional development
- to increase the opportunities of gainful employment
- to help in raising the standards of living
- to reducing disparities in income and wealth (by preventing private monopolies and curbing concentration of economic power and vast industries in the hands of a small number of individuals).

The rationale of public enterprises in India was to take independent India, in the words of Pandit Jawaharlal Nehru, to the 'commanding heights'. The strategy was to quicken the pace of economic development and strengthen the Independent India in basic industries, defence requirements, public utilities and infrastructure. All these were the areas where it was not possible to mobilise private investment. Private institutions cannot invest large funds and wait for an indefinitely long period for the returns on their investment.

Achievements of Public Enterprises

The achievements of public enterprise are vast and varied. They are:

1. setting up a number of public enterprises in basic and key industries.
2. generating considerably large employment opportunities in skilled, unskilled, supervisory and managerial cadres.

3. creating internal resources and contributing towards national exchequer for funds for development and welfare.
4. bringing about development activities in backward regions, through locations in different areas of the country.
5. assisting in the field of export promotion and conservation of foreign exchange.
6. creating viable infrastructure and bringing about rapid industrialisation (ancillary industries developed around the public sector as its nucleus).
7. restricting the growth of private monopolies
8. stimulating diversified growth in private sector
9. taking over sick industrial units and putting them, in most of the cases, in order.
10. creating a financial system, through a powerful networking of financial institutions, development and promotional institutions, which has resulted in social control and social orientation of investment, credit and capital management system.
11. benefiting the rural areas, priority sectors, small businesses in the fields of industry, finance, credit, services, trade, transport, consultancy and so on.

Let us see the different forms of public enterprise and their features now.

Forms of Public Enterprise

Public Enterprises can be classified into three forms:

(a) Departmental undertaking
(b) Public corporation
(c) Government company

These are explained below.

DEPARTMENTAL UNDERTAKING

This is the earliest form of public enterprise. Under this form, the affairs of the public enterprise are carried out under the overall control of one of the departments of the government. The government department appoints a managing director (normally a civil servant) for the departmental undertaking. He will be given the executive authority to take necessary decisions. The departmental undertaking does not have a budget of its own. As and when it wants, it draws money from the government exchequer and when it has surplus money, it deposits it in the government exchequer. However, it is subject to budget, accounting and audit controls.

Examples for departmental undertakings are Railways, Department of Posts, All India Radio, Doordarshan, Defence undertakings like DRDL, DLRL, Ordinance factories, and such.

Features

1. *Under the control of a government department* The departmental undertaking is not an independent organisation. It has no separate existence. It is designed to work under close control of a government department. It is subject to direct ministerial control.
2. *More financial freedom* The departmental undertaking can draw funds from government account as per the needs and deposit back when convenient.

3. *Like any other government department* The departmental undertaking is almost similar to any other government department.
4. *Budget, accounting and audit controls* The departmental undertaking has to follow guidelines (as applicable to the other government departments) underlying the budget preparation, maintenance of accounts, and getting the accounts audited internally and by external auditors.
5. *More a government organisation, less a business organisation* The set up of a departmental undertaking is more rigid, less flexible, slow in responding to market needs.

Advantages

1. *Effective control* Control is likely to be effective because it is directly under the Ministry.
2. *Responsible executives* Normally the administration is entrusted to a senior civil servant. The administration will be organised and effective.
3. *Less scope for misutilisation of funds* Departmental undertaking does not draw any money more than is needed, that too subject to ministerial sanction and other controls. So chances for misutilisation are low.
4. *Adds to Government revenue* The revenue of the government is on the rise when the revenue of the departmental undertaking is deposited in the government account.

Disadvantages

1. *Decisions delayed* Control is centralised. This results in lower degree of flexibility. Officials in the lower levels cannot take initiative. Decisions cannot be fast and actions cannot be prompt.
2. *No incentive to maximise earnings* The departmental undertaking does not retain any surplus with it. So there is no incentive for maximising the efficiency or earnings.
3. *Slow response to market conditions* Since there is no competition, there is no profit motive, there is no incentive to move swiftly to market needs.
4. *Redtapism and bureaucracy* The departmental undertakings are in the control of a civil servant and under the immediate supervision of a government department. Administration gets delayed substantially.
5. *Incidence of more taxes* At times, in case of losses, these are made up by the government funds only. To make up these, there may be a need for fresh taxes which is undesirable.

Any business organisation to be more successful needs to be more dynamic, flexible, responsive to market conditions, fast in decision making and prompt in actions. None of these qualities figure in the features of a departmental undertaking. It is true that departmental undertaking operates as an extension to the government. With the result, the government may miss certain business opportunities. So as not to miss business opportunities, the government has thought of another form of public enterprise, that is, Public Corporation.

PUBLIC CORPORATION

Having realised that the routine government administration would not be able to cope up with the demand of its business enterprises, the Government of India, in 1948, decided to organise some of its enterprises as statutory corporations. In pursuance of this, Industrial Finance Corporation, Employees' State Insurance Corporation were set up in 1948.

Public corporation is a 'right mix of public ownership, public accountability and business management for public ends'. The public corporation provides a machinery which is flexible, while at the same time retaining public control. A public corporation has total freedom in planning, management and control of its operations. It can formulate its own budget. It can recruit staff at different levels based on the necessary specialisation. Public corporation is also called *statutory corporation.*

Definition

A public corporation is defined as a "body corporate created by an Act of Parliament or Legislature and notified by the name in the Official Gazette of the Central or State Government. It is a corporate entity having perpetual succession, and common seal with powers to acquire, hold, dispose off property, sue and be sued by its name."

Examples of a public corporation are Life Insurance Corporation of India, Unit Trust of India, Industrial Finance Corporation of India, Damodar Valley Corporation, and others.

Features

1. *A body corporate* It has a separate legal existence. It is a separate company by itself. It can raise resources, buy and sell properties, by name sue and be sued.
2. *More freedom in day-to-day operations* A public corporation has a high degree of operational freedom in its day-to-day affairs. It is relatively free from any type of political interference. It enjoys administrative autonomy.
3. *Freedom regarding personnel* The employees of public corporation are not government civil servants. The corporation has absolute freedom to formulate its own personnel policies and procedures, and these are applicable to all the employees including directors.
4. *Perpetual succession* A Statute in Parliament or State Legislature creates it. It continues forever and till a statute is passed to wind it up.
5. *Financial autonomy* Though the public corporation is a fully owned government organisation, and the initial finances are provided by the Government, it enjoys total financial autonomy. Its income and expenditure are not shown in the annual budget of the government. However, for its freedom it is restricted regarding capital expenditure beyond the laid down limits, and raising the capital through capital market.
6. *Commercial audit* Except in the case of banks and other financial institutions where chartered accountants are auditors, in all corporations, the audit is entrusted to the Comptroller and Auditor General of India.
7. *Run on commercial principles* As far as the discharge of functions, the corporations shall act as far as possible on sound business principles.

Advantages

1. *Independence, initiative and flexibility* The corporation has an autonomous set up. So it is independent, take necessary initiative to realise its goals, and it can be flexible in its decisions as required.
2. *Scope for Redtapism and bureaucracy minimised* The corporation has its own policies and procedures. If necessary they can be simplified to eliminate redtapism and bureaucracy, if any.

3. *Public interests protected* The corporation can protect the public interests by making its policies more public friendly. Public interests are protected because every policy of the corporation is subject to ministerial directives and broad parliamentary control.
4. *Employee friendly work environment* Corporation can design its own work culture and train its employees accordingly. It can provide better amenities and better terms of service to the employees and thereby secure greater productivity.
5. *Competitive prices* The corporation is a government organisation and hence can afford with minimum margins of profit. It can offer its products and services at competitive prices.
6. *Economies of scale* By increasing the size of its operations, it can achieve economies of large scale production.
7. *Public accountability* It is accountable to the Parliament or legislature. It has to submit its annual report on its working results.

Disadvantages

1. *Continued political interference* The autonomy is on paper only and in reality, the continued political interference disturbs the work environment of the corporations. Pressures for employment, providing facilities, operating at low margins restrict the freedom of the public corporation.
2. *Misuse of power* In some cases, the greater autonomy leads to misuse of power. It takes time to unearth the impact of such misuse on the resources of the corporation. Cases of misuse of power defeat the very purpose of the public corporation.
3. *Burden for the government* Where the public corporation ignores the commercial principles and suffers losses, it is burdensome for the government to provide subsidies to make up the losses.

GOVERNMENT COMPANY

Section 617 of the Indian Companies Act defines a government company as "any company in which not less than 51 percent of the paid up share capital* is held by the Central Government or by any State Government or Governments or partly by Central Government and partly by one or more of the State Governments and includes a company which is subsidiary of government company as thus defined."

A government company is the right combination of operating flexibility of privately organised companies with the advantages of state regulation and control in public interest.

Government companies differ in the degree of control and their motives also.

Some government companies are promoted as

- industrial undertakings (such as Hindustan Machine Tools, Indian Telephone Industries, and so on)
- promotional agencies (such as National Industrial Development Corporation, National Small Industries Corporation, and so on) to prepare feasibility reports for promoters who want to set up public or private companies.
- agency to promote trade or commerce. For example, State Trading Corporation, Export Credit Guarantee Corporation and so such like.

* ... a change to 33% because presently Government of India wants to disinvest ... with the

- a company to take over the existing sick companies under private management (eg. Hindustan Shipyard)
- a company established as a totally state enterprise to safeguard national interests such as Hindustan Aeronautics Ltd., and so on.
- mixed ownership company in collaboration with a private consultant to obtain technical know-how and guidance for the management of its enterprises. eg. Hindustan Cables.)

Features

The following are the features of a government company:

1. *Like any other registered company* It is incorporated as a registered company under the Indian Companies Act, 1956. Like any other company, the government company has separate legal existence, common seal, perpetual succession, limited liability, and so on. The provisions of the Indian Companies Act apply for all matters relating to formation, administration and winding up. However, the government has a right to exempt the application of any provisions of the government companies.
2. *Shareholding* The majority of the shares are held by the Government, Central or State, partly by the Central and State Government(s), in the name of the President of India. It is also common that the collaborators are allotted some shares for providing the transfer of technology.
3. *Directors are nominated* As the government is the owner of the entire or majority of the share capital of the company, it has freedom to nominate the directors to the Board. Government may consider the requirements of the company in terms of necessary specialisation and appoints the directors accordingly.
4. *Administrative autonomy and financial freedom* A government company functions independently with full discretion and in the normal administration of the affairs of the undertaking.
5. *Subject to ministerial control* Concerned minister may act as the immediate boss. It is because, it is the government that nominates the directors, the minister issues directions for a company and he can call for information related to the progress and affairs of the company any time.

Advantages

1. *Formation is easy* There is no need for an Act in legislature or parliament to promote a government company. A government company can be promoted as per the provisions of the Companies Act, which is relatively easier.
2. *Separate legal entity* It retains the advantages of public corporation such as autonomy, legal entity
3. *Ability to compete* It is free from the rigid rules and regulations. It can smoothly function with all the necessary initiative and drive necessary to compete with any other private organisation. It retains its independence in respect of large financial resources, recruitment of personnel, management of its affairs, and so on.
4. *Flexibility* A government company is more flexible than a departmental undertaking or public corporation. Necessary changes can be initiated, within the framework of the company law. Government can, if necessary, change the provisions of the Companies Act, if found restricting the freedom of the government company. The form of government company is so flexible that it can be used for taking over sick units promoting strategic industries in the context of national security and interest.

5. *Quick decisions and prompt actions* In view of the autonomy, the government company can take decisions quickly and ensure that the actions are initiated promptly.
6. *Private participation facilitated* Government company is the only form providing scope for private participation in the ownership. This facilitates to take the best, necessary to conduct the affairs of business, from the private sector and also from the public sector.

It is true that a government company has relatively higher ability to compete in open market environment. But the poor performance of majority of the government companies reveals that they lack the necessary dynamism, initiative, foresight and commitment to survive in a competitive environment. They continue to be affected by the political and government interference, lack the professionalism in their approach to business. A government company is characterised by frequent changes in the boards of directors, lack of continuity in the policies, inability to respond to the market changes and initiatives of the competitors. In a majority of the cases, the role of the government company had not been more than a silent spectator for the rapid changes in the market.

The emergence of the TITAN watch company as a market leader stands as a classic case against HMT watch division, which once upon a time was the 'time-keepers for the Nation'.

The following are the disadvantages of a government company.

Disadvantages

1. *Continued political and government interference* Government seldom leaves the government company to function on its own. Government is the major shareholder and it dictates its decisions to the Board. The Board of Directors gets these approved in the general body. There were a number of cases where the operational policies were influenced by the whims and fancies of the civil servants and the ministers.
2. *Higher degree of government control* The degree of government control is so high that the government company is reduced to mere adjuncts to the ministry and are, in majority of the cases, not treated better than the subordinate organisation or offices of the government.
3. *Evades constitutional responsibility* A government company is created by executive action of the government without the specific approval of the Parliament or Legislature.
4. *Poor sense of attachment or commitment* The members of the Board of Management of government companies are from the ministerial departments in their ex-officio capacity. They lack the sense of attachment and do not reflect any degree of commitment to lead the company in a competitive environment.
5. *Divided loyalties* The employees are mostly drawn from the regular government departments for a defined period. After this period, they go back to their government departments and hence their divided loyalty dilutes their interest towards their job in the government company.
6. *Flexibility only on paper* The powers of the directors are to be approved by the concerned Ministry, particularly the powers relating to borrowing, increase in the capital, appointment of the officials, entering into contracts for large orders and restrictions on capital expenditure. The government companies are rarely allowed to exercise their flexibility and independence.

Problems of Public Enterprises

Though the concept of public enterprise was designed efficiently, it was not put into practice in the right perspective. With the result, the public enterprises could not deliver the targeted results. They were

Table 9.1 Forms of Public Enterprises: Features at a Glance

Features	Departmental undertaking	Public corporation	Government company
1. Formation	Formed by an executive order of the government	Comes into existence by Statute of Parliament or State Legislature	Registered under Companies Act, 1956
2. Legal position	An extension to a government department	Separate legal entity	Separate legal entity
3. Finances	Budget of the concerned ministry provides capital	Government provides the initial capital	Government provides a minimum of 51 % of capital and the balance is raised from the other sources.
4. Degree of autonomy	Nil	Fairly good	High
5. Flexibility	Nil. It has to adhere to the rules and regulations of the ministry	More flexibility in its internal operations within the framework of the statute	Total flexibility. It can frame its own rules and regulations
6. Power to recruit staff	Manned by government employees and civil servants	It can recruit its own staff based on its specific needs.	It can recruit its own staff based on its specific needs.
7. Control mechanism	Controlled by the officials of the concerned Ministry	Government nominates the directors	Government appoints the directors
8. Power to borrow	It can borrow subject to the prior approval of Government	It can borrow from Government and also public	It can borrow from Government and also public
9. Suitability	Where firm control over vital sectors such as Defence and so on is required	For public utilities and service undertaking suuch as Electricity Boards and so on.	To operate in free market environment

allowed to function independently and in due course of time, they completely lost their autonomous character. A review of the progress made in the last five decades reveals that the following are some problems that have been tormenting the public enterprises.

Political interference Public Enterprises are created to preserve their operational autonomy in administration of their own affairs. Unfortunately, due to political interference, they were not allowed to act upon independently. Whether it is location of enterprise or appointment of chief executives and other key personnel or workers or solution to the problem such as strikes, at very level, heavy political interference is clearly visible. The public enterprises has to function against several odds such as interference